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HUMAN ASSET ACCOUNTING: A RECONSIDERATION OF SOME CONTENDING ISSUES

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Abstract
There have been arguments as to whether human resource should be included in the financial statement or not. While the proponents of its inclusion are of the view that human assets are the most valuable assets in an organization and should therefore be included, those against it based their argument on the fact that human beings are not owned by organization in the legal sense of it. It is on this premise that this paper seeks to put in proper perspective the reasons why the accounting profession has maintained the status-quo despite the clamour for inclusion of human resource in the financial statement. The paper argues that the absence of a faithful and reliable model for measuring the value of human asset is one of the main reasons for its non-inclusion in the financial statements. It is recommended that, until the development of a reliable model, the inclusion of human resource in the financial statement should be limited to sports, like football where the value of players, to an extent, can be determined with some level of certainty and reliability, and the players can be tested for impairment periodically unlike employees in other organizations.

Key Words: Human resource, Human resource accounting, Asset, Financial, statement, Cost Models, Economic value models

Introduction

Over the years the accounting profession has been criticized for non-inclusion of human resource in the financial statements. This has become an issue of controversy and debate among accountants and non-accountants alike. It could be seen in a number of outbursts by different writers. For instance, Wood and Sangster (1999) contended that one of the main limitations of normal financial accounting is the lack of any inclusion of the 'value' of the workforce of an organization. In the same vein, Appleby (1994) stated that normal accounting information does not give any indication of the value of personnel in the firm. O'Regan (2006) captured the causes and consequences of this development thus:

> …the reason for this is that accounting has traditionally focused its attentions on capturing and representing items that are tangible. Knowledge and people are outside the comprehension of this model. Thus, their largest "assets" go unrecognized in the balance sheets of most knowledge- intensive firms. This is probably not very enlightening from a pure accounting point of view. Consequently, accounting's capacity to fulfill its function as supplier of relevant information has diminished as it has struggled to come to terms with items to which it limited conceptual framework can assign neither value nor tangible existence. (p. 480)

Accepted that human assets, the most valuable asset to an organization is not reflected as assets in financial statements, however the foregoing shows that a lot of people, accountants and non-

accountants alike have not really come to terms with the basis for the non-inclusion of workforce in financial statement. It is against this backdrop that this study was undertaken to put in proper perspective why the accounting profession is yet to change the status- quo on human resource accounting.

Concept of Human Resource Accounting

Ramana (2013), UKessay (2013) and Garg (n.d) sees Human Resource Accounting (HRA) as a new development in Accounting. UKessay, (2013) has it that the first stage in the development of HRA was from 1960 to 1966. It was in 1960s that behavioural scientists attacked the conventional accounting practice for its failure to value human resource of the organization along with other productive resources (Garg, n.d). What then is human resource to an organization and by extension human resource accounting? According to Megginson (as cited in UKessay, 2013) human resource is the total knowledge, skills, creative abilities, talent, attitudes and belief of an organization workforces as well as values, attitude and belief of the individuals involved. In the same vein, Garg (n.d) maintained that human resources have certain distinct characteristics from other physical assets like personality, self control, devotion, quality, skills, talents, loyalty and initiativeness. With this background, various authors put forward different definitions for HRA. Ramana (2013) defined HRA as the process of assigning, budgeting, and reporting the cost of human resources incurred in an organization, including wages and salaries and training expenses.

According to American Accounting Association (as cited in ICAN Distance Learning Pack, 2000) it is the process of identifying, measuring and communicating information about human resources to decision- maker. It is the systematic recording of transactions relating to the value of human resources (Garg, n.d). Flamholtz (as cited in Ramana, 2013) defined HRA as the measurement of the cost and value of the people for an organization. From the foregoing, the concept of HRA is all about recognizing human resource like other fixed assets in an organization. Fixed assets have been described by Johnson and Whittam (1984) as those assets which provide service to the business for a longer period than one year. Thus argument for HRA is that, like other fixed assets investments in human assets provide benefits that accrue for more than one accounting period and should be capitalize as against the current practice of expensing them as they occur. This is in compliance with the matching principle, which states that the expenses of a particular period should be matched with the revenue of that period.

Importance of Human Asset Accounting

It is unarguable that human beings are very important in any organization. This fact is constantly stressed in business literatures. For instance, Appleby (1994) maintained that it is only when other assets are combined with human assets that the full potential of an organization can be realized. Aligning with this fact, Uzor (2004) contended that if a loss making company installs highly rated management quality, one can buy their shares in confidence that management will turn the situation around. Samuels and Wilkes (1980) argued that the earnings basis of valuation is based on the assumption that the old managers will stay on, or that any new managers put in to run the business will be able to maintain the profit level.

Therefore, if human assets are appropriately accounted for in the financial statement, the following benefits among others are derivable:

i. The income statement comparability from one period to another is enhanced since the cost of human assets will be evenly distributed.
ii. The range of assets shown on the balance sheet will increase providing more useful information to users.
iii. Human assets would be regarded as investments and not expenses to be borne out of current income.
iv. Business valuation will be done with all relevant information.

On their own part, Wood and Sangster (1999) opined that such development have the benefits of having financial statements that are more complete and managerial decisions can be made with a fuller understanding of their implications. The foregoing shows that the accounting profession is not oblivious of human resource as a great asset in an organization and the importance of its inclusion in the financial statement.

Human Assets Valuation Models

Over the years several models have been proposed for HRA. The models may be classified into two: Cost models and Economic Value Models.

Cost Models

Given that cost is the amount of cash or equivalent given to acquire property or services (UKessay, 2013), the cost models include the following among others:

Historical or Acquisition Cost Model: This model involves capitalization of the actual cost incurred on recruiting, selecting, hiring, training, and developing the human resources of the organization (Garg, n.d). This model suffers from the shortcomings of historical cost. For instance, as rightly observed by the American Accounting Association (as cited in Obara, 2013), the economic value of human asset does not necessarily correspond to its historical cost, any appreciation or amortization may be subjective and has no relationship to any increase or decrease in the productivity of the human assets. They equally maintained that because the cost associated with recruiting, selecting, hiring, training, placing and developing an employee differ from one individual to another within a firm the historical cost method does not result in comparable human resource value. UKessay (2013) identify the following among other as the limitations of historical cost model:

1. Difficulty in estimating use of human resources. One cannot tell when an employee may quit a job.
2. The economic value of human resources may increase with experience, but amortization reduces the reported value. It is difficult to reconcile the two.
3. People may learn things outside the organization which will be useful in their jobs yet these may not be taken in account.
4. Training and development cost that are capitalized do not guarantee employee increased performance.

Replacement Cost Model: This is the cost expected to be involved to replace human services at death, retirement or resignation (ICAN Distance Learning Pack, 2000). One major limitation of this model is that no two human beings are alike in terms of abilities. It

could therefore be subjective. Garg (n.d) contended that defining what is replacement costs and measuring it is one problem of this model. Market imperfection is equally a problem, and also the perception by an employee of its replacement cost might reflect in his behaviour which may affect the overall profitability or objective of the organization. Contributing to the limitation of replacement cost model, ICAN Distance Learning Pack, (2000) maintained that management may have some particular asset which it is unwilling to replace at current cost but which it wants to keep using because the asset has a value greater than its scrap values.

Opportunity Cost Model: This model attempts to estimate the value of human resources by establishing an internal labour market in an organization through the process of competitive bidding (Garg, n.d). According to Obara (2013) The "scarce" employees include only those employees within the firm who are the subject of recruitment request by an investment centre manager. In other words, employees who are not considered "scarce" are not included in the human –asset based of the organization. This presupposes that this model cannot value employees who have no alternative use. The method may be perceived as artificial and even immoral (Obara, 2013).

Economic Value Models
These models use the concept of present value to value human resource. Some of the models are as follows:

Lev and Schwartz Model: This model states that the human resource of a company is the summation of value of all the Net present value (NPV) of expenditure on employees (Dutta, 2008). According to Lev and Schwartz the value of human capital embodied in a person of age K is the present value of his remaining earnings from employment. Their formula for calculating the value of an individual is given as follows:

$$V_k = \sum \frac{I(t)}{(1+r)^{t-k}}$$

Where:
V_k = the value of an individual r years old
I(t) = the individual annual earnings up to retirement
r = a discount rate specific to a person.
t = retirement age

Dutta (2008) outlined the limitations of this model to include:
i. It is essentially an input measure .It ignores the output i.e. productivity of employees;
ii. the service state of each individual employee is not considered;
iii. the training expenses incurred by the company on its employees are not considered;
iv. the attrition rate in organization is also ignored;
v. factors responsible for higher earning potentiality of each individual employees like seniority, bargaining capacity, skill, experience etc. which may cause differential salary structures are also ignored.

Apart from the above other shortcomings, it is a fact that market imperfections and high unemployment has made wages and salaries not to be a good surrogate of employee's value. Evidence abound that employees are in most cases not fairly compensated, especially in developing economies. There is also the problem of how to arrive at an appropriate discount rate per employee. An employee that may be seen as honest may end to be fraudulent in an organization. On the other hand, using the company cost of capital would not be rational.

Stochastic Reward Valuation Model: The model as proposed by Flamholtz determines an individual's value to an organization by the services he is expected to render to the organization during the period he is likely to remain with the organization in various position or service states (Mohatan, 2014). According to Gupta (n.d) the model suggests a five step approach to assess the value of an individual to the organization. These are:
a) Forecasting the period a person will remain in the organization i.e., his expected service life.
b) Identification of service states i.e. the roles he might occupy and the time at which he will quit the organization.
c) Estimating the value derived by the organization when a person occupies a particular position (service state) for specified time period.
d) Estimating the probability of occupying each possible mutually exclusive service state at specified future times.
e) Discounting (at a specified predetermined rate) the expected service rewards to their present value.
It is unarguable that to obtain data for the determination of employee's value under this model is at best a shot in the dark.

Hermanson's Model: Roger H. Hermanson suggested two models for the measurement of human resources. These are unpurchased Goodwill Model and Adjusted Discounted Future Wage Model. Under the first model it is argued that super normal profits in a firm are the indicators of presence of human resources (Garg, n.d). Thus, the value of human resource is calculated by capitalizing earnings in excess of normal earnings for the company or the group of companies of which the firm is a part (Mohanta, 2014). Its main limitation is that since the methods limits recognition of human resources to the amount of earnings in excess of normal, the human resource base that is required to carry out normal operations is totally ignored (Articlebase, 2010). As a result, the value of human assets will be an underestimation.The second model uses compensation in form of wages and salaries as a surrogate measure of person's value to the firm (Garg, n.d). The discounted future wage stream is adjusted by an "efficiency ratio" which is the weighted average of the ratio of return on investment of the given firm to all the firms in the economy for a specified period, usually five years. The weights are assigned in the reverse order, i.e. 5 to the current year and 4 to next year and so on.
The following formula is used:
Efficiency Ratio =

$$5\frac{RF_0}{RE_0}+4\frac{RF_1}{RE_1}+3\frac{RF_2}{RE_2}+2\frac{RF_3}{RE_3}+\frac{RF_4}{RE_4}$$

Where:
RF_0 is the rate of accounting income on owned assets for the firm for the current year.
RE_0 is the rate of accounting income on owned assets for all the firms in the economy for the current year.
RF_4 is the rate of accounting income on owned assets for the firm for the fourth previous year.
RE_4 is the rate of accounting income on owned assets for all the firms in the economy for the fourth previous year.

Obara (2013) identified a number of limitations of this model but suffice to mention these two. First, it assumes human resource to be the total of all "unowned" assets, making no allowance for unowned assets other than human resource or for the various bases used for stating owned assets on the organization books. Secondly, the future compensation is as much a measure of the liability of the firm employing the individual as it is an asset.

Factors Militating Against the Inclusion of Human Value in Financial Statement
The non capitalization of human asset in the financial statement is with some good reasons that are premised on the fundamental principles of accounting. For instance, from the review of the some of the key human assets valuation models as seen in this paper none is capable of measuring human resource faithfully and reliably. In line with the concept of prudence an asset that cannot be measured reliably is not capitalized. Another way of looking at prudence is to only record a revenue transaction or an asset when it is certain (AccountingTool, 2014). The concept of prudence was aptly captured by Michie and Verma (n.d) when they assert that assets whether tangible or intangible which is hard to measure and value are not capitalized in the balance sheet. Therefore, in accordance with the prudence concept human asset costs are expensed in the period in which it occurs. The same treatment applies to other similar assets. For instance, in relation to research and development cost Jupe, Manson, Rutherford and Wearing (1995) are of the view that it is dangerous to capitalize costs where their recovery is uncertain. It therefore means that where assets, no matter their form, are uncertain one has to exercise a little bit of caution to avoid greater regret thereafter.

Some have argued that the models can be used to estimate the value of human resource since the use of estimate is an important component in the preparation of financial statements. The fact is that there are rules guiding the use of estimates in accounting. Reasonable estimates may only be relied upon as long as forming the estimates do not involve a high degree of subjectivity and uncertainty. However, the available models for human assets valuation are subjective and uncertain. Therefore, the use of estimate in the determination of human asset value is neither credible nor reliable.

The International Financial Reporting Standard (IFRS) definition of asset is also another reason for the non-inclusion of human asset in the financial statement. According to IASB (as cited in Collings, 2012 p.72) "an asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise". It has been argued in accounting literature that employees are not owned as assets in the legal sense of it. However, the definition emphasis control as against ownership. Thus, human beings do not fulfill the aspect of the definition that an asset is a resource controlled by an enterprise even though the aspect of expected future economic benefits may assured to some

extent. However, in the football industry, the scenario is different. It can be argued that football clubs have control over a player once the transfer fees have been paid and contract signed. Until the contract period expires, the player is being controlled by the club. The club may even decide to sell a player before the expiration of his contract period. As Michie and Verma maintained, players may help generate revenue, and can be sold. They equally contended that there is an active transfer market in football players. This presupposes that the price of player can be determined at arm's length transaction. For instance, just to mention a few, David Luiz was bought by PSG from Chelsea for £50m on a five years contract (Weekend Soccerstar, 2014), and Cesc Fabregas was bought by Chelsea for £27m on a five years contract (Soccerstar, 2014). As at August 2014, Manchester United have agreed a transfer fee of £59.7m to sign Angel Di Maria from Real Madrid, and Bayern Munich was reported to have reached an agreement with Roma for the signing of Mehdi Benatia for £24m (Daily Trust, 2014). The foregoing is in line with the disposition of Amir and Livne (2005) when they contended that assets acquired at arm's length transaction should be capitalized. To them the rationale behind this presumption is that the transaction price provides reliable evidence about the fair value of the acquired assets. That is why players may be reflected as assets in the financial statement. However, this cannot be said of other organizations employees and not even the use of bond could change this position because there are ways of resolving bond and the employee will be free. The above position is consistent with the requirements for recognition of intangible assets. According to Alfredson, Leo, Picker, Loftus, Clark and Wise (2011p.144) an intangible asset is recognized as an asset (in terms of the framework) if:

- It meets the definition of an intangible asset;
- It is probable that the future economic benefits attributable to the asset will flow to the entity; and
- The cost of the asset can be measured reliably.

  Thus, this paper make bold to say that definitional benchmark is not the principal reason for the non-inclusion of human assets in the financial statement. The main issue is that currently human asset cannot be measured objectively and reliably. At present, it is doubtful if organizations have all that it takes to undertake periodic evaluation of human assets to ensure their carrying value does not exceed the benefits expected to be derived from the human asset in line with IAS 36 (Impairment of Assets).

This paper is of the view that if there exist, a model that can measure human resource with much certainty, the concept of substance- over- form will prevail over the argument of workforce not being owned or controlled in the legal sense of it.

Conclusion

This paper has argued that the accounting profession is not unaware of the effect of non-inclusion of the human asset in the financial statement. Due to several problems that are associated with attempts at measuring human resource, the probable option currently is to write-off human resource expenses in compliance with the prudence concept. Any attempt to do otherwise could results in unimaginable consequences. Apart from the behavioural problems that may arise from employees dislike of values placed on them, the use of any of the proposed models for human asset valuation is a veritable tool for creative accounting. Therefore, for now the reporting of human resource in the financial statements should be restricted to sports, where

for instance, transfer fees can be taken as a reliable surrogate of the value of players. Apart from that, players are the stock in trade for clubs. Data for the determination of players' value are readily available and players as assets can be tested for impairment which is almost an impossible task for other industries.

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