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CONFLICT OF HUMAN RESOURCES ACCOUNTING AND EMPLOYEE BENEFIT VALUATION MODEL: AN EXIT STRATEGY PROPOSED

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Abstract

Since early 70s, the non inclusion of human capital values in financial reports has been perceived as under reporting by the public. Accounting Practitioners have been finding ways around it while accounting teachers have developed several theories which are yet to gain general acceptance. The model developed in this study followed the general principles of discounting adopted in Lev & Schwartz model which states that the human resource of a company is the summation of all the net value (NPV) of all expenditure on an employee. The variables in the model are universal or are of common characteristic to all organizations globally. The workability of the model is based on the fact that it seeks to capitalize all significant cost incurred from the very point of sourcing for an employee to the point the Enterprise obtains the obligation to pay for those perceived services receivable, properly discounted at an appropriate discount rate r in a given period n. The paper posits that an objective value of an enterprise human resource is that future value which is placed on the employee by the employer and is accepted by the employee i.e. terms of employment. The implication of the model is that published account will now depicts the true value of the organization. The study recommend among others that an IFRS should be developed to provide an appropriate rate of discount that will be adopted universally in the discounting of employee future benefits receivable from the employer and secondly to develop IFRS adopting employee benefits as the basis of determining the value of human capital globally.

Keywords: *Human Resources, Accounting, Human Capital, Account, and Discounted.*

Background to the Study

The valuation and Accounting for human resources has been an issue of significant importance in accounting discussions both in practice and theory across the globe since the early 70s. Practitioners have been finding ways around it while accounting teachers have developed several theories which are yet to gain general acceptance. The crux of the arguments is that human resource is perceived as the most valuable asset of an enterprise and yet it is not reported upon and the overall accounting reporting system has not provided for it as well. Raunak (2010) observed that "the IABS and the ASB in different countries have not been able to formulate any specific accounting standard for measurement and reporting such valuables elements. Valuer's and users of accounting information are of the view that the non inclusion of the value of human resource in the accounting system and in published accounts of reporting enterprises amount to under reporting globally. Gunner (2003), citing the work of (Lev; 2001, Powell and Schipper, 1999; Estein. And Pava, 1993) noted that 'studies on shareholder use of corporate annual reports revealed that the usefulness of financial statement reports of publicly listed companies had declined, creating an information gap between the issuer of information' this has been the challenge of the accounting profession and practice. Studies over time also, have emphasized the need for the determination of an acceptable parameter for the determination of the value of human resource to be presented in the published account of reporting enterprise.

In response to the investigated loss of relevance of financial information, practioners and researchers proclaimed the increasing necessity for new accounting methods that also provide additional disclosure of information on intangibles to close the information gap" (Lev,1999 and Wallman, 1996) Then, if principles of fair value presentation apply to all classes of assets. This may as well be applied to human resource. Given that when a given class of asset is desired by an enterprise, it sort and acquire it at the prevailing market price i.e at arm let transaction. It follows that the fair value principles would required that all the associated cost to bring it to it final destination and use should be included to arrive at it fair value. Similarly, an enterprise acquires human resource at amount which may include salaries and wages etc agreed between the labor and the enterprise, and associated cost to bring the human resource to the point of use. The deference between the human resource and other assets is that assets may either be acquired for cash or on credit basis and is subsequently subjected to depreciation which represent the portion that is used up of the asset at the end of the accounting period where as the human resource is neither acquired for cash or credit but a commitment have been obtained and an obligation on the part of the enterprise has been established by virtue of the agreement reached and acknowledged by the issuance of an appointment letter to the employee, meanwhile, the portion of the human resource that is used up is paid for by way of salaries and other benefits at the end of each month or cumulatively at the end of the year similarly, training and development costs that improves human resource productivity and efficiency are like repairs and maintainace which are capitalized if significant in nature and improves the life span of the asset. The inability of studies and practice to establish this significant point has been the root of human resource valuation and accounting problem globally.

Objective of the study

The study is carried out to develop a set of valuation model and accounting procedures to be adopted in the determination, recording and presentation of human capital values in the accounting systems and published financial statements globally.

Review of related literature & Theoretical Framework

During the two last decades, several advocates of HRA, including Herman & Mitchell (2008) ,Flamholtz et al. (2003), Pekin Ogan (1988), Chris Dawson (1994), Flamholtz (2004), Lev & Schwartz (1971), Elias (1972), Hendricks (1976) and others have suggested that HRA could benefit external users of financial statements. External decision makers must know the changes in human assets in order to evaluate properly assets and income. The conventional accounting profit may be misstated and the asset base distorted, if the condition of human assets changes during the period, (Flamholtz, 1999). Most of the arguments against the possibility of accounting for human capital revolve round the financial quantification of knowledge and skills of the human resource.

Accounting for human resource by the proponent of this belief is seen to be accounting for intangibles which of course are mostly abstract and unquantifiable in financial terms. The knowledge of human resource translates in their innate abilities which are only are applicable when situation demand, when so applied, the performance of the enterprise is most often affected by way of either direct increase in activities, revenue or profits. Organizations are usually very prompt at compensating its human resource on this application of these innate abilities through annual bonuses, profit sharing policies, awards and other related benefit packages. In line with this argument, Mamta (2012) observed that "it can also be inferred that value of employees is higher than sales per employee. If there is reverse situation, companies need not pay much amount to their employees because they are not much efficient to receive such large amount". Also noted at some other instance that high performing organizations in order to keep performing on a continuous basis must treat their human resource as the most important and valuable asset. They should treat them as adult, partners and with dignity and respect. As we all know that 'people who feel good about themselves produce good results' and 'people who produce good results feel good about themselves'. Such a healthy and virtuous cycle goes on and on, satisfying the individual goal and organizational goal too at same time , in that the individual derives job satisfaction, which in turn induces him to reach out for excellence, culminating in the all round development of the performing organization.

Conner (1991) proposed that the resource theory considers human resources in a more explicit way. This theory considers that the competitive position of a firm depends on its specific and not duplicated assets. The most specific (and not duplicated) assets that an enterprise has are its personnel. It takes advantage of their interdependent knowledge. That would explain why some firms are more productive than others. With the same technology, a solid human resource team makes all the difference (Archel, 1995). No doubt, when a firm invests in human resources by acquisition and training, it duplicates a future generation of profits and services that will be produced by these assets. Referring to training, the (AECA) (1994) states that one of the techniques showing a greater capacity to stimulate efficiency is based on the idea that an employee who is induced to get to know his job better is more productive and quicker on the job. Training in firms is an activity that develops the worker's capacity to improve efficiency and job quality, therefore, the enterprise increases its profitability.

The training concept is generally used to define three different issues which, in practice, are difficult to distinguish: capacitating, training, and development. Capacitating is the worker's acquisition of knowledge and skills necessary for his job. Training better adapts the worker to the job, and development focuses on promotion to higher job level. All these as mentioned involve a considerable level of cost to achieve by the organization and they translate in the increase in the value of and efficiency of the human capital or resource, such cost is expensed through the income statement as required in applicable accounting standards. Meanwhile, in relation to other assets, the relevant accounting standard on the treatment of all additional cost incurred to bring about increase in both efficiency and the life of physical or fixed assets are be capitalized. This requirement also would apply to all costs associated with human resource if fair value presentation is to be achieved in financial reporting, since such costs induce productivity, efficiency and job quality among the enterprise human assets.

Interest in measuring human capital has shown that “There is a clear absence of correspondence between the real assets in the present firms and those recognized in the balance sheet…In fact, assets are too related to its juridical conception (that is, owned by the firm…), in front of a pure economic approach where asset is every instrument or way that can be used in the production distribution firm's process or, in general, every category of economic value which can be transformed into goods or services or any instrument at the service of the firm or that the firm uses, regardless of its juridical state…and also all those goods and rights that the firm does not own now but used to own or will own later on, by virtue of collateral contracts or agreements which may induce it.” So, a diagnosis is reached about the predominant asset concept. This situation can be explained by two important problems that are met when referring to intangibles: Identify the assets cost and estimate the period in which the asset should be amortized. In international accounting, besides clearly recognizing some items as assets (cash, stock, machinery, and so on) there is great debate whether certain other items are considered capitalization. These are known as deferred charges in English accounting literature (Hendriksen & Breda 1992). It can be said then that not only are the limits unclear between intangible, fixed assets and deferred charges, but also which elements are considered assets and which elements are considered expense. Measurement problems do represent methodological challenges but “should not prevent the study of human assets” (Coff 1997). March (2006) reminds us that variables that cannot be measured may be more valuable than those that can.

Hermanson, Ivancevich and Hermanson (1992) use compensation as surrogate measure of a persons' value to a firm noted that compensation means the present value of future stream of wages and salaries to employees of the firm. The discounted future wages stream is adjusted by an 'efficiency ratio' which is weighted average of the ratio of the return on investment of the given firm to all the firms in the economy for a specified period , usually the present and preceding four years. The efficiency ratio measures the rate of effectiveness of the human resources operating in the entity over a five year period. A ratio greater than one, implies that the return of the firm is above the average ratio of return for all the firms in the economy. The efficiency ratio has been criticized by certain authors as subjective because of arbitrary weighing scheme and restricting the valuation period to five years.

Following Likert (1971) definition of human resource accounting which states that human resource accounting is an attempt to identify and report investment made in the human resources of an organization that are not presently accounted for under conventional accounting practice. Basically, it is an information system that tells the management what changes overtime are occurring to the human resources of the business, and of the cost and value of the human factor to the organization. The system may serve both the internal and external users,, providing management(internal user) with relevant data on which to base recruitment , training and other development decisions and supplying investors, lenders and other external users of financial statement with information concerning the investment in and utilization of human resource in the organization. It follows that an appropriate model for the valuation of a human resource should be a model which incorporates costs (wages and salaries, training and development) and related benefits accruable to the employee as they occur.

This paper posits that an objective value of an enterprise human resource is that future value which is placed on the employee by the employer and is accepted by the employee i.e. terms of employment. This value translates in the salaries, wages and other benefits the organization pays to the employee, which may differ from industry to industry and is influenced to a very large extent by a given labour market. This position is aptly supported by previous studies. Model for measurement of original human resource costs According to Flamholtz's (1973), states that human resource costs may be explained in terms of the two major categories of acquisition costs and learning costs. Acquisition costs include the direct costs of recruitment, selection, hiring and placement, and the indirect costs of promotion or hiring from within the firm. Learning costs include the direct costs of formal training and orientation and on-the-job training. In a human resource accounting system, these costs are reported in asset accounts with future economic benefits rather than as expenses.

Also Faribor &. Raiashekar, (2011) observed that the most appropriate of evaluation method of HR based on viewpoints of experts and by using qualitative characteristics of accounting information. Results of the survey indicate that historical cost method, also called the original cost, is the most applicable method in current status of Iranian companies. In this method human resource cost (HRC) includes the acquiring, recruit, training and development costs. This method has greater acceptability by tax agencies and it is more common than other methods in the accounting operations of assessment assets. Concerning the findings, they further observed that the selection of the most appropriate method of applicability have been designed based on theory of accounting measurement. These methods include historical cost, replacement cost, opportunity cost, and stochastic method with rewards, estimated feature cost and estimated feature benefits. Qualitative characteristics include objectivity, reliability, relevancy, punctuality, impartiality, cost-effectiveness, adaptability with the current systems of accounting.

Therefore, the only model that can be adopted as the basis of valuing human capital is the employee or human resource cost model. This is because, the variables in the model are universal as every enterprise pays wages, salaries, training and development and other benefits in an almost the same way and manner and there is seemly no disagreement between the employees and employers. To adopt the model would mean admittance of liabilities arising from future obligations with to employee benefits. This again is in line with Herman & Mitchell (2008) discussed how reporting under a human resource liability paradigm fits into the traditional accounting framework of contingent liabilities; examine the financial effects of such reporting on market valuation and internal planning; and explore measurement of human resource liabilities. From reviews of financial effects of human resource liability reporting the research logically extends those results to support the proposed paradigm.

A commonly accepted economic definition of capital is “that which has been invested” (Schuller 2007), on which the firm seeks to generate a return. Human capital has been defined as the source of income embodied in the individual employee (Lev& Schwartz 1971). A firm's stock of human capital is therefore the sum of its employees' human capital. Many, if not most, accountants acknowledge that human capital is part of the capital of the firm. Flamholtz, Sullen and Hua (2003) acknowledge that “there ought to be no doubt that they [human resources] are indeed economic resources and a form of capital – human capital". While there may be acceptance of human resources as being part of the firm's capital, few accountants accept that it should be included in accounting reports and even fewer agree on how it should be done. This is not surprising given that financial reporting has traditionally been based on principles of reliability, verifiability and objectivity. The debate has generally centered on whether human capital can be classified as an asset and how it can be measured. While authors such as Lev and Schwartz (1971) and Flamholtz et al. (2002; 2003) have suggested methodologies for valuing human capital to enable it, like other forms of capital, to be incorporated into financial accounts, it is fair to say that the acceptance and adoption in practice has been limited.

Human Capital theory attempts to explain differences between human and nonhuman capital, in part due to a perceived need to measure investment in national education and industrial training (Wang, Dou & Ni 2002). Accounting and HR scholars are Cognizant that "in a free society, the enterprise cannot own, only rent, its human capital" (Wiig 1997). This characteristic of human capital means the firm will suffer a capital loss - in the form of a cost (employment and training of replacement) or a lost opportunity (such as utilizing specialist expertise in a new way) This fact is acknowledged by some accountants such as Flamholtz (1999) but not reported or recorded in financial statements. In the following section, therefore, the paper provides support for the feasibility and need to adopt a human resource liability paradigm for valuing, reporting and managing human resources.

Basic Conditions or Assumptions of the Proposed Model

The following are the basic conditions upon which the model for human capital accounting is based:

1. That an objective value of a human resource is a function of what the employer is willing to pay and accepted by the employee at a given point in time.
2 That what the employer pays at any given point is an average value of the overall future cost of the contribution of the employee to the enterprise
3. That application of innate abilities by employees is promptly accounted for by rewards outside wages and salaries such as bonus, allowances, awards and profit sharing,
4. That training and development enhances employee's abilities to meet the enterprise perceived worth of an employee that is being paid for.
5. That employee compensation includes direct and indirect benefits.
6. That career growth as per present policies and weighted for incremental earnings depends on cadre.
7. The future earnings or cost on the employee is discounted to present value to eliminate the effect of changes in prices level or inflation.
8. That the organization maintains a standard human resource acquisition, training and development programme upon which the human resource budget is based.

Human Resource Valuation Model

The model developed in this study is based on the general discounting principles adopted by Lev & Schwartz (1971) model which states that the human resource of a company is the summation of value of all the net value (NPV) of all expenditure on an employee. By noting that human capital embodied in a person of age r is the present value of his earning from employment. The major criticism leveled against Lev & Schwartz model is that:

1 It is essentially an input measure that ignores the output i.e. productivity of employee.
2 That the service of each individual employee is not considered.
3 That the training expenses incurred by the company on its employees are not considered.
4 That the attrition rate in organization is also ignored.
5 Those factors responsible for higher earnings potentiality of each individual employee like seniority, bargaining capacity, skills, experience etc which cause differential salary structure are also ignored.

This model is therefore built on the concept that the objective value of a human resource is the perceived worth or benefits derivable from his / her services by the enterprise which to a very large extent determines what he or she is paid or the benefits or rewards he / she get from the enterprise. This implies that Human Capital Value HCV is the totality of the stream of benefits accruable to an employee or costs incurred on an employee for services rendered over a given period of time. The variables in the model are universal or are a common characteristic to all organizations globally. The workability of the model is of the fact that it capitalizes all significant cost incurred from the very point of sourcing for the employee to the point the enterprise obtains the obligation to pay for those perceived services receivable, properly discounted at an appropriate discount rate. The model is shown as follows:

$$HCV = \frac{(TARC + TW+TS+TA+TTC)}{(1+r)^0} + \frac{(TARC + TW+TS+TA+TTC)}{(1+r)^1} + \ldots + \frac{(TARC + TW+TS+TA+TTC)}{(1+r)^n}$$

Where:
HCV=human capital value
TARC = total advertisement and recruitment cost per year.
TW=total wages per year
TS=total salaries per year
TA= total allowance per year
TTC= total training and development cost per year
1+r= discount factor
0-n= current year to year n

Accounting Treatment of Human Capital Value
The recording of human capital cost which the value is obtained by adopting the above model should be amortized over the average life span of the human resource in the organization. The recording in the books of account will involve two main accounts viz:
1 Human resource asset account
2 Human capital redemption account: is an account for all the liabilities arising from the enterprise human capital obligations.

Other accounts that are affected by transactions on the above accounts are:
1 Personal income tax account
2 Health insurance account
3 Pension fund administration account.

The journal entry below shows the posting processes in the accounts stated above:

	Details	Dr	Cr
1	Human capital value Being the enterprise human Resource obligation contracted.	Human resource Asset a/c	human capital redemption a/c
2.	When payment is made i.e salary, wages etc Being human resource cost redeemed	Human capital Redemption a/c	cash/Banker
3.	at the end of the year Being human capital obligation redeemed during the year	profit & loss a/c	human resource asset a/c
4.	Pension contribution being 8% &10% of contributory pension,	Human resource asset a/c	human capital redemption a/c
5.	when payment is made to Pension administrators Being redemption of pension Obligation arising from human Resource obligations	Human capital Redemption a/c	cash/bank a/c
6.	At the end of the year Being the total pension obligation For the year.	profit & loss a/c	human resource asset a/c
7.	When company stock are issued As compensation to employee Being share compensation to Employees.	Human capital a/c	share capital a/c
8.	At the end of the year Being amortized portion of Share compensation to Employees	profit & loss a/c	human resource asset a/c

9.	Health insurance charges Being total value of health Insurance paid	Human Resource Asset a/c	Health Insurance a/c
10.	At the end of the year Being health insurance Charge written of to P&L a/c	profit& loss a/c	Human resource asset a/c
11.	Personal income tax Being personal income Tax for the year	Profit and Loss a/c	Human Resource Asset a/c

All costs of insignificant nature such as meal subsidy, transportation allowance e, accommodation cost should be expensed as they do not add directly to the creative abilities of a human resource. This proposed model and accounting procedures if adopted by reporting enterprises will lead to the achievement of the principal objectives of human resource accounting as enunciated by Harbour (2013) that the main objective of Human Resource is to assign financial value to Human capital and management activities by recording and Analyzing these activities in an economic and financial context and by Vatasoiu (2012) as follows that the objective is to achieve:

1 Proper management of human resource
2 Improvement of human resource
3 Depicting the true value of the organization
4 Providing quantitative information on human resource which helps the managers and investors in making decisions.
5 Human resource accounting communicates the worth of human resource to the organization and to the public.

Conclusion

In a systematic way, this paper presented the accounting treatment for human resource in modern day enterprises. It noted that all costs relating to human resource that essentially will improve on the efficiency, productivity and job quality of the human resource should be capitalized. This implies that Human Capital Value HCV is the totality of the stream of benefits accruable to an employee or costs incurred on an employee for services rendered in a given period of time. The model presented in this study followed the general principles adopted by Lev & Schwartz. The study also set out the accounting procedures that will be followed in the recording and presentation of human capital values in accounting records, published accounts and financial statements.

Recommendations

1. An IFRS should be developed to provide an appropriate rate of discount that will be adopted universally in the discounting of employee future benefits derivable by the employer
2. To develop IFRS adopting employee benefits as the basis of determining the value of human capital globally.
3. To develop a set of IFRS on the condition or assumptions to guide in the recording, preparation and presentation of human resource values in both in the books and annual reports of reporting entities globally.
4. Mandatory continued professional training should be made compulsory for all categories of accountants i.e. both in practice and in employment so as to promote adoption of HRV.
5. Management reports in published financial statements should now include paragraphs explaining the changes in the enterprise human resource values during the year.
6. Five years financial summary should as well be provided for human resource accounting.
7. Auditing standard should now include clauses that will require that auditors' reports should accommodate additional paragraph on human resource value certification.

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