
A conceptual review of human resource accounting and human capital valuation models

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ABSTRACT

The focus of this paper is to evaluate human resource accounting and human capital valuation models. Today in the accounting parlance, human resources is treated in financial statements as an expense item rather than as an intangible asset which has capacity to generate future stream of incomes. Non-treatment of human resource as an asset obviously distorts the value of economic information presented in the financial statement to internal and external decision makers on the real and potential value of the organization most valuable assets. There are different models used to value human resources in an organization. The purpose of this paper is to look into human resource accounting and human capital valuation models. The methodology adopted for this study is library approach which focuses on content review of extant literature on human resource accounting and human capital valuation. The study concluded that human capital is one of the most important resources that can positively impact on a firms profitability and efficiency. Hence, capitalizing human resource costs is conceptually more valid than the expensing approach. Accounting for human capital constitutes an explicit recognition of the premise that people are valuable organizational resources and an integral part of a mix resources. Also, human resource accounting information of an organization is a crucial factor for decision makers in an era of competitive economic. We proposed that Financial Reporting Council of Nigeria (FRCN) and other relevant entities develop human resource accounting standards for human resource identification and measurement, since this would ensure uniformity in disclosures and a reliable comparison of human resource value

Keywords: Human Resource Accounting (HRA), Human Resources, Human Capital Valuation and Organization.

1. INTRODUCTION

The global economy has been shifting from an industrial economy to an information-based economy as a result of the internet and other new technologies. As a result, human capital is now more valuable to businesses than ever before. Other intangible assets can be quite accurately accounted for. Despite being far more complex than other intangible assets, it is still important that accountants establish a means of accounting for human capital. Doing this would perhaps be the most significant discovery in the history of financial accounting, but the Financial Accounting Standards Board cannot issue a mandate requiring corporations to report that valuable information until a credible measure of human capital is established. Such an activity would only result in wrong information, leading to misguided decisions. (Stanko *et.al.*, 2014). Human resource accounting is the science of carefully valuing, recording, and showing the worth of human resources in the accounts of a business. The process of discovering and quantifying data on human assets (resources) and distributing this information to relevant parties is known as human resource accounting. This will allow firms to make sound decisions about internal and external issues. Human assets, like other physical assets, have the power to generate expenditure and income. As a result, human forces must be valued similarly to other assets, that is, the costs and benefits of human resources must be considered. (American Accounting Association, 2014).

Human resources, is often known as human assets or capital; which refer to the group of people who make up an organization's or a company or other Firms. (Edom *et.al.*, 2015; Syed, 2009).

Economists refer to human resource as human capital; this being seen as a production factor, and they explore different ways of measuring its investment in education, health and other areas. These resources exist in employees as implicit knowledge and are one of the operational elements influencing an organization's effectiveness or performance (Hajkarimi, 2009). Perhaps the most important source of an organization's processes is human resources, because it is employees' ideas that affect a company's financial and physical resources to generate financial return, such as return on equity, net profit margin, gross profit margin, etc. (Charles, 2001). Universally, companies need to develop a competitive advantage, it is important that firms truly leverage on the employees as a competitive tool.

A strategy for increasing organizational profitability (e.g., return on investment, return on equity, net profit margin, etc.) in order to produce higher net present value for the firms has emerged. Organizations strive to improve their workforce through

comprehensive human capital development activities not just to optimize organizational goals, but also for long-term survival and sustainability (Marimuthu *et.al.*, 2009). Organizational success greatly hinge on the aptitude of the human assets to resourcefully optimize other assets such as land, equipment and money.

Therefore, human resources have come to be regarded as the paramount assets at the disposal of organizations. Enofe *et.al.*, (2015) acknowledged that “our greatest assets are our people” is declared in most organizations’ annual accounts and reports at all stages and areas of organizations. If human resources are adequately remunerated and recognized at all stages of firms will lead to human capital efficiency; which is required with machine efficiency for enhanced performance. Valuation of this resource is necessary and information about valuation must be given to all stakeholders of an organization in the financial statement.

Human Resource Accounting (HRA) delivers valuable information to both internal and external accounting users. It assists internal users (such as management) in making decisions on human resource employment and use, as well as transfers, promotion training, and retrenchment. It serves as a foundation for developing physical assets in relation to human resources, as well as evaluating the costs of providing additional education, training, and development to employees in terms of the benefits gained by the organization, among other things.

Human Resource Accounting (HRA) is an accounting method designed to account for people as organizational resources by providing stakeholders with information on the projected value and cost of investing in human resources in an organization. It was created to address a flaw in the traditional accounting system, in which all investments in human resources are written off as expenses in the year they are made. Human resource accounting assesses an organization's human resources in a methodical manner and records them in the financial statement of annual report to communicate their worth, changes over time, and results achieved from their use to financial statement users. The importance and necessity of human resources Accounting as a method of evaluating human resources is widely accepted, and despite the obstacles, it is progressively being used in many nations. (Islam *et.al.*, 2013).

The original cost of human capital is refers to the sacrifices that was incurred to select, hire and develop people (Andrade and Sotomayor, 2011). However, human capital is valued according to the age and skills as average annual compensation is determined for different age groups (Lev and Schwartz, 1971). Although, there are different models use to value human capital in an organization. Some of them still

suffer some drawbacks. Some of the valuation models includes: stochastic model of Eric Flamholtz (1972), Likert model, Lev and Schwartz model (1971), Morse model (1973), Pekin organ's model (1976) and Sk Chakraborty model. This paper is conceptual and it focus on the review of human resource accounting and human capital valuation models.

Objective of the Study

The objective of this study is to evaluate human resource accounting and human capital valuation models.

2. LITERATURE REVIEW

Human Resource Accounting (HRA)

According to Fajana, (2002), Human resource accounting was developed in response to criticism of traditional accounting systems for failing to meet the needs of users, and the accepted practice of treating all expenditures on human capital formation as an immediate charge against income is incompatible with the treatment accorded to comparable expenditures on physical capital. HRA is thus an extension of accounting rules that demand revenue to be matched with expenses incurred to produce that amount of revenue, as well as data organization to communicate important information. Quantifying the value of human resources enables management to cope with variations in their quantity and quality, allowing for an equilibrium to be achieved between the required resources and the benefits of such resources.

Human resources accounting, according to the American Accounting Association (2014), is the act of discovering and quantifying data on human assets (resources) and presenting this information to relevant parties. This will allow firms to make informed judgments about internal and external issues. Like other physical assets also have the power to generate expenditure and income. As a result, human resources must be valued similarly to other assets, that is, the costs and benefits of human resources must be considered.

According to Jasrotia (2004), human resource accounting can be seen as the assessment and reporting of the cost and value of people as organizational resources. The HRA's reporting aspect is what distinguishes this definition. This definition is based on the notion that employees' knowledge and intellectual capacities are becoming increasingly relevant in corporate investment decision-making. Also Human resource or capital accounting, as described by Flamholtz et al., (2002), is accounting for people as an organizational resource. It entails calculating the

cost incurred by firms in recruiting, selecting, hiring, training, and developing human resources.

Rahaman et al. (2013) provided a more detailed definition of human resource accounting, defining it as the process of evaluating the costs incurred by businesses and other organizations to recruit, select, hire, train, and develop human assets. This definition specifies how human resource expenditure should be recognized for valuation and reporting purposes. In other words, HRA entails measuring the economic value of individuals to organizations. According to Gupta (1991), human resource accounting is essentially an information system that informs management about changes in the business's human resources over time. It entails accounting for human capital investment and replacement costs, as well as the economic value of people in a company. As a result, human resource accounting gives a complete look at one technique of employing human resource cost and value information in decision-making.

The Concept of Human Capital

Human capital, according to Bontis et al. (1999), is the human aspect in the organization; the combination of intelligence, talent, and competence that gives the company its specific character. It is the knowledge and skills which individuals create, maintain and use (Armstrong, 2006). People's innate, behavioral, and personal energy are those parts of the organization capable of learning, changing, innovating, and giving the creative push that, if properly motivated, can assure the organization's long-term existence (Bontis et al., 1999).

Human capital is a broad word that refers to an employee's competencies, abilities, training, and motivation, as well as the talents, knowledge, and experience possessed by an individual or group of individuals, as measured by their value or cost to a company or country. The organization's human capital consists of all of the attributes and professional skills that the worker offers to the organization. Human capital is owned by the worker and leaves along with him whenever he leaves organization. (Anuonye, 2015). Human asset or capital is one of the most important resources that can positively impact on a firm's profitability and efficiency. Capitalizing human resource costs is conceptually more valid than the expensing approach.

Human Capital Valuation Models

Human capital valuation is critical in any firm from accounting perspective. Human asset appraisal, account recording, and fair disclosure of such information in financial statements are the demands of stakeholders in the context of improving

managerial performance and employee productivity. There is a genuine need for reliable and complete information that can be used in improving and valuing human assets. This valuation of human asset involve the determination of investment in human resources and the benefits received from human asset in form of human capital or employees' efficiency (that is, value added or created) Samuelson and William (2009) The following are the models used by corporate entities for valuing their human capital:

Stochastic Model of Eric Flamholtz (1972)

This model considers an employee's possibility or likelihood of moving from one function to another in his career, as well as his possibility or chance of leaving the organization sooner, such as through resignation, retirement, or otherwise. The disadvantage of Eric Flamholtz's Stochastic Model is that it ignores the reality that individuals who work in a group may have a higher value to the company than those who work individually. The approach falls short of practical utility in the analysis of operational capabilities, in that the chances must be computed for each individual occupying various states of service, and these probabilities must be determined for all times and employees on an individual basis (Akintoye, 2012)

Likert Model

In the 1960s, Rensis Likert was the first to examine Human Resource Accounting (HRA), highlighting the importance of strong pressure on HR's qualitative aspects and their long-term benefits. The Likert model is a value-based methodology that is not monetary in nature. According to the Likerts approach, human variables are categorized into three:

- Casual Variables
- Intervening Variables
- End-Result Variables (job satisfaction, cost, productivity and earnings).

Lev and Schwartz Model (1971)

Lev and Schwartz model proposed (1971) estimating future earnings throughout the employee's remaining service life and discounted the expected earnings at the cost of capital to arrive at the present value. The model seek to evaluate the worth of human capital with a given age connected with a company. The disadvantage is that it does not provide the accurate value for human capital and does not quantify their contributions to organizational effectiveness (Akintoye, 2012).

Morse Model

This model is proposed by Morse during 1973 and it also called Morse Net Benefit Model. According to this model, the present value of the net benefits gained by the firm from the service of its employees is equal to the value of human resources. This strategy involves the following steps:

- The gross value of the service that employees will provide in the future., both individual and collectively.
- The value of future payments (both direct or indirect) to the employees.
- The excess of the value of future human resources over the value of the future payment is determined.
- This would be the net advantage to the company because of human resource.

Pekin Ogan's Model (1976)

Pekin Organ created this model in 1976. This is an enhancement to the Morse net benefit technique. When assessing the value of human resources using this method, evaluate the certainty with which future net benefits would accrue should also be considered when calculate the value of human resource, according to this model. The method requires determining the following:

- Each employee's net benefit
- The degree of certainty with which the advantages will be provided.
- Net benefits from all employees multiplied by their certainty factor equal net benefits with certainty.

Sk Chakraborty Model

Sk Chakraborty of Indian Institute of Management's was the first Indian to try Human Resource appraisal technique. Sk Chakaraborty observed that the cost of each employee's recruitment, learning, selection, training, and development should be considered for the acquisition cost technique of valuation and categorised as a separate revenue item that can be written off. The balance, not the amount written off, should be reported separately on the balance sheet under the heading of investment. To assess the present value of human resources, the average employee's periods of employment and average future salary should be discounted at a reasonable rate and displayed as an investment on the asset side of the balance sheet, which should be added to the capital employed on the liability side.

According to Sk Chakraborty, separate valuations can be done for management and non-management employees. To compute the discount, use the estimated average

after -tax return on capital employed from the traditional balance sheet. The Chakraborty Model considered both the acquisition technique and the current worth of the asset.

3. METHODOLOGY

The methodology adopted for this study is library approach which focuses on the content review of extant literature on human resource accounting and human capital valuation models.

4. CONCLUSION AND RECOMMENDATIONS

The study examines human resource accounting and capital valuation model. The study concludes that human capital is one of the most important resources that can positively impact on a firms profitability and efficiency. Hence, capitalizing human resource costs is conceptually more valid than the expensing approach. Also, capitalizing human resource cost would significantly impact the growth of corporate firms and disclosure as intangible asset in the statement of financial position will motivate the employees. Furthermore, accounting for human capital constitutes an explicit recognition of the premise that people are valuable organizational resources and an integral part of a mix resources. Again, human resource accounting information of an organization is crucial factor for decision makers in an era of competitive economy.

The following policy recommendations were offered in this present study:

- Corporate firms should capitalize their human resource cost to augment their profitability. This will enable the shareholders to know the total human asset value of the organization and the manager can also make accurate, timely and informed decision.
- There should be a regulation in the accounting standard setting process for human capital reporting and proper techniques should be developed for valuation of human resources and generally acceptable method should be adopted for disclosure in the financial statement of organization.
- Standard of human resource accounting should be created by Financial Reporting Council of Nigeria (FRCN) and other relevant bodies for human resource identification and measurement as it would ensure uniformity in disclosures and a reliable comparison of human resource value.

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