Anappraisal of Human Resource Accounting In Organisation: A Case of Nigeria

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Abstract: The study of human resources is as old as the study of business activities. Early economists recognized the labour force and entrepreneur as fundamental factors for any production or service activity to take place. However, this class of assets is never given a proper treatment in the financial statement. “It is perfectly true that the accounting treatment of people shows them as cost” Drucker (1977). An accounting system where people or human resources are treated as ‘capital investment’ will not only affect the preparation of financial statements but will ultimately affect organizational performance. Triangulating existing knowledge on the topic, while stating the ideas in practical and useable form, the paper examines the need, concept and evaluates the usefulness and application of human resource accounting to organization. Using the desktop approach our analysis shows that the implementation of human resource accounting in organisation's annual financial report will go a long way in improving organisational performance. The paper recommends that there is no doubt that accounting bodies such as the International Accounting Standard Board, the International Federation of Accountants and other recognised bodies need to make pronouncements on the inclusion of Human Resource Accounting in the preparation and interpretation of financial statements.


I. Introduction

Human resource accounting is the process of assigning, budgeting and reporting the cost of human resources incurred in an organization, including wages and salaries and training expenses. It is an art of knowing the cost invested for employees towards their recruitment, training them, payment of salaries and other benefits and in return knowing their contribution to organization towards its profitability. It gives information regarding inner strength of organization and helps in making decisions regarding long term investment in that organization.

It is a new branch of accounting based on the traditional concept that all expenditure on human capital formation be treated as a charge against the revenue of the period as it does not create any physical asset. As at now this concept has changed and the cost incurred on any asset, as human resources should be capitalized as it yields benefits measurable in monetary terms.

Human resource is one of the most important back office operations of any organization or business. Their skills, creativity, ability, can’t be replaced by machines. At all levels and areas of business or firm human efficiency is required with machine efficiency. Valuation of this resource is necessary and information about valuation must be given to all the stakeholders of business through financial statements. Conventionally, financial assets are accounted in the books of accounts as per the generally accepted accounting principles (GAAP), but it doesn’t count the human asset. Although many efforts have been made by many school of thought in this area

Human Resource Accounting not only involves measurement of all cost or investment associated with the recruitment, placement, training and development of employees but also the quantification of the economic value of the people in an organization. Therefore, it is an attempt to identify and report investment made in human resources of an organization that are not presently accounted for under conventional accounting practices. Moreover, human resource accounting helps to measure the value of employees, which helps the management take vital decisions related to human resources in order to increase production.

American Accounting Association (1973) defined “Human Resource Accounting as the process of identifying, measuring data about human resources and communicating this information to interested parties” R.L.Woodruff (1989) defined “Human Resource Accounting as an attempt to identify and report investment made in human resources of an organisation that are presently not accounted for in conventional accounting practice”.

Management Scholar Edward Lawler (1992) described human resources from investment perspective as “to be competitive, organizations in many industries must have highly skilled, knowledgeable workers. They
must also have a relatively stable labour force since employee turnover works directly against obtaining the kind of coordination and organizational learning that leads to fast response and high quality products and services.”

1.1 Need for Human Resources Accounting

The need for Human Resources Accounting (HRA) was felt because of growing concern for human relations management in industry. Experts felt that failure on the part of accountants to evaluate human resources was the main hurdle in effective management. The need for HRA is thus felt because of the following:

a. Non-availability of Information in Conventional Accounting: The need for HRA is felt because of non-availability of information in respect of human resources to an organisation in conventional accounting. This makes the job of attaining objectives of the organisation difficult for managers at the end of the day. People are important assets for the organisation who help in making physical and financial resources operationally effective.

b. No Record of Human Assets: The physical resources have recorded value of assets but there is no record available of human assets of the organisation corresponding to human capital which constitute an important aspect of productivity; and profitability of firms depend on their contribution. Accounting does not treat human capital in the same manner as non-human capital. With the neglect of value of human capital in accounting practice, assessment of the total value of the firm is not possible. That is why the need for human resources accounting is essential.

c. No Balance Sheet of Human Resources: The need for HRA is essential to prepare statement of financial of value of human assets with capital assets so that the real worth of the firm get reflected in the statement of financial position of the firm and the valid comparison between the two firms can be easily made. This will reflect true performance of the firm which will strengthen investor's interest in the firm.

d. Expenses on Training and Development: The present accounting system treats expenses incurred on training and development of the employees and the fringe benefits offered to them as current cost and written against current revenue.

Blind eye is turned to the fact that these expenses are the investment made by the firm on human capital, the benefits of which, result over a period of time extended beyond one year. It is a general feelings among managers to cut down expenses on human development ignoring the fact that effective motivation and high morale resulting from these expenses can benefit the firm immensely later in terms of high performance, high productivity, high profitability and high quality. It is for this fact there arises a need for human resources accounting.

e. Reflection in Financial Statements: Today’s need is that the value of human resources should be reported in the financial statements, that is, the statement of financial position and profit and loss account of the organisation. It is essential “to understand the management decision on human capital which is possible through reflecting them in the financial statements of the organisation.

In the accounting practice which is followed today, the expenses incurred on human resources are charged against revenue of the accounting period in which they are incurred. But the fact is that the benefits of human resources can be extended to several accounting periods, not just one. Accountancy cannot justify this because of uncertainty of tenure of employees. The need of human resource accounting arises because of the above facts.

1.2 Method of Human Resources Valuations

a. Historical Cost Method: This method is based on costs incurred on recruitment, training, and familiarisation etc. It is developed by Renis Likert. This is a very simple method based on traditional principles of accounting. Under this method an attempt is made to have a proper match between cost and revenue. The advantage of this method is that the organisation can show the value of human capital in its statement of financial position and profit and loss account, the weak point of this method, however, is that it fails to fulfil the need of developing a system of HRA based on systematic valuation of human resources.

b. Replacement Cost Method: Under this method the replacement cost of existing personnel is estimated. Replacement cost includes the cost of recruitment, training and opportunity cost for the intervening period. This serves the purpose of making valuation of human resources in future. The hiccup in this method is that the value differs from person to person making it difficult to find identical replacement of the present human assets.

c. Economic Value Method: The payment made to the human resources until their retirements are calculated and appropriately discounted to determine their present economic value.

d. Standard Cost Method: This method is an improvement over replacement cost method. Under this method the standard costs of recruitment, training and development are developed and established every year to overcome complications in calculations. Their costs represent the value of human resources for accounting. It is easy for implementation and control.
e. Present Value Method: Under this method the net contributions of employees to the earning of the organisation are discounted to have present value of human resources.
f. Current Purchase Power Method: In this method the historical costs are converted into current purchasing power of money with the help of index numbers.
g. Opportunity Cost Method: Under this method the value of human asset is determined in their alternative use of the next best alternative use. This value forms the basis for valuation of human asset of organisation. For calculation of opportunity cost bidding method is used. But it is difficult to decide bid or offer.

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<th>Table 1: The Costs of Human Resources</th>
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1.3 Advantages of Human Resources Accounting (HRA)

There are certain advantages that will accrue to the organisation which are listed below:
a. Explains Return on Capital Employed: Human resources accounting reveals the valuation of human resources employed by the organisation. This enables the organisation to explain and interpret the return on capital employed. Furthermore, it is possible to know the long-term dimensions of business performance.
b. Improvement in Decision Making: For making HRA the detailed and up-to-date records relating to human resources are to be maintained. This helps managers to take right decisions in respect of recruitment, promotions, transfers, retention and retrenchment in the best interest of the organisation in the light of budgetary provisions.
c. Increased Productivity: HRA subsists upon the avenue for increasing productivity of human resources. This is possible because valuation in monetary terms is made of human asset and this valuation find a place in financial statements of the organisation. This motivates the employees to put greater efforts. Also, the feeling of a sense of belonging to the organisation is developed among the employees. They are now identified as valuable resources of the organisation.

In India the concept of HRA is yet to gain momentum because the financial statements are prepared according to the company law where there is no scope for showing valuation of human resources. Only the salaries paid to them can be exhibited. However, companies can have a mention about the worth of human assets in the schedules or notes. In India companies like Minerals and Metal Trading Corporation of India, Oil and Natural Gas Commission, Bharat Heavy Electrical and some of the corporate bodies have adopted the concept of HRA. Once it has made a headway, it will be adopted by many companies in the country.

1.4 Types of Costs

The American Accounting Association (1970) defines human resource accounting as “the human resources identificationand measuring process and also its communication to the interested parties. There are two reasons for including human resources in accounting (Ripoll and Labatut, 1994). First, people are a valuable resource to a firm so long as they perform services that can be quantified. The firm need not own a person for him to be considered a resource. Second, the value of a person as a resource depends on how he is employed. So management style will also influence the human resource value.

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<th>Table 3: Learning Costs</th>
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II. Literature Review

2.1 The Concept of Value in Human Resources

The need to value human resources is essentially what human resources accounting entails, that is, the determination of an appropriate value for the “human asset” in the context of a firm. In view of the unique nature of the asset, there is the need to give a clear picture of what can be referred to as value on ground Gago, (1976) in value analysis identified four kinds of “economic value”. Out of the four kinds of his description of value, the three values that are relevant to this paper are:

a. Cost Value: The cost of a product which includes material, labour and other attributable cost.
b. Use Value: The properties and qualities that accomplish a use, work or service.
c. Esteem Value: The features, qualities or characteristics that make us want to own it. With respect to human asset, the value of the human asset could be any of the following:
   i. Cost Value: Cost of recruitment, procurement and development.
   ii. Use Value: Service rendered or goods produced by the employees.
   iii. Esteem Value: The qualities, that is, the unique qualities of the employee that encourage the employer to want to retain him or her continually. This refers to competency, accuracy and efficiency which are intrinsic worth of the employee. The contribution of Walsh has not put an end to the controversy surrounding what value is despite its laudability. The Oxford Advance Learners’ dictionary refers to value as “the worth of something in terms of money or other goods for which it can be exchanged. This definition agrees with Walsh’s view about cost and value. Let us refer to the writing of Bonbright (1973) for further clarification. He defined the value of an asset with respect to human assets as a measure of the rights or legally recognised interest attached to the asset. This definition comes under the scope of Walsh’s use definition.

III. Usefulness Of Human Resources Accounting

a. The inclusion of a value for human resources in the financial statements, affords managers the opportunity to recognise the importance of their greatest asset in financial terms.
b. It assists the management in the adoption of manpower policy that is not based on desirable social goal but rather that will facilitate the organisation’s economic good.
c. It encourages management to make full and proper use of human resources at their disposal.
d. It can be used as a basis for evaluating the effectiveness and efficiency of the organisation’s labourforce. Depletion in the organisation’s human asset is good indication of workers attitude to work.
e. It gives a more complete picture of the state of things on ground in the organisation.
f. It serves as a data base for personal policies that will take cognisance of the concepts of asset, costs and value, in an attempt to obtain, maintain and retain a satisfactory and satisfied workforce.
g. It acts as a means of educating management about the need to become sensitive to their human resources since their success depends largely on worker's behaviour and attitude to work.
h. Managerial heads are made to see the human resources as assets, which must be given needed protective custody like other assets. They are expected to ensure improvement in its value. They should, therefore, work towards reducing threats to human resources that leads to high labour turnover.

IV. Application Of Human Resources Accounting

The contribution of Pyle (1966) at the University of Michigan, United States is worth mentioning. He was an employee of RG Barry Corporation of Columbus. Ohio, US. This company was the first to adopt the concept of human resources accounting. This was done in the 1972 financial statements. The company has a staff strength of 1,700 and was quoted as a small shoe manufacturing company on the American stock exchange. The company employed five result variables for its performance evaluation. The variables are profit, solvency, physical assets, organisational human assets and customer loyalty assets.

The company found its accounting system wanting in providing the information for the measurement of the least two variables from the inception, the company considered three different methods to develop information on investments in human resources.
(i) Outlay Cost
(ii) Replacement Cost
(iii) Economic Value.

Eventually, all these three were used because the company recognised that multi-dimensional measurement and reporting were needed to meet its information needs as related to human resources.
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company believed that the implementation should be regarded as a gradual process of installing one set of measurement at a time, refining it and expanding its application before moving to the next stage, until the whole model was made fully operational.

The company identified seven costs which must be capitalised and amortised over time. They are:

- Recruiting
- Acquisition
- Orientation
- Training
- Familiarisation
- Information Development
- Formal Development

V. Conclusion

Human resources has been recognized as an important factor of production but has not been given its place as an asset in the financial statement of organisations. The implementation of human resource accounting in company's annual financial report will go a long way in improving organisational performance as human resource accounting provides quantitative information about the value of human assets, which helps the management to take decisions regarding the adequacy of human resources and based on these insights, further steps for recruitment and selection of personnel can be taken. Outside the organization, it has an impact on the decisions of the investors, clients and potential staff of the company. When proper valuation and accounting of human resources is not done then the management will not recognize the negative effects of certain programmes, which are aimed at improving organisational profitability. If not recognized on time, these programmes could lead to a fall in productivity levels, high turnover rates and low morale of existing employees etc. Various methods of valuation of human resources were identified:

- Historical cost method
- Value added method
- Replacement cost method
- Investment method
- Opportunity cost method
- Expected realisable value
- Economic value method
- Standard cost method
- Present value method
- Current purchase power method.

The cost centers to be accumulated were also identified as follows:

- Recruitment
- Acquisition
- Orientation
- Training
- Familiarisation
- Development.

VI. Recommendations

There is no doubt that accounting bodies such as the International Accounting Standard Board, the International Federation of Accountants and other recognised bodies need to make pronouncements on the inclusion of Human Resources Accounting in the preparation and interpretation of financial statements.

* At the local level, the Nigeria Accounting Standard Board, the Institute of Chartered Accountants of Nigeria and the Association of National Accountants of Nigeria are also expected to look into this emerging field.

* The various organisations/companies and especially multi-national enterprises need not to wait for the various bodies to compel them before taking steps to benefit from Human Resource Accounting.

* The National Universities Commission and other tertiary examination bodies should also include this course in the training curriculum of new accountants and human resources experts.

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