

HUMAN RESOURCES ACCOUNTING – ACCOUNTING FOR THE MOST VALUABLE ASSET OF AN ENTERPRISE

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Employees are the most important assets of an enterprise and its success or failure depends on their qualifications and performance. Human resources are not properly evaluated because the enterprises consider the wages, actually an investment in the qualification and improvement of the staff as expenditure and not as an investment in the most important asset of an enterprise – the human capital. The current accounting system is not able to provide the actual value of employee capabilities and knowledge. This indirectly affects future investments of a company, as each year the cost on human resource development and recruitment increases. Human resource accounting is a direct part of the social accounting and aims to provide information on the evaluation of one of the most important components of the organization, namely human capital. This article seeks to show the importance of human resources for an enterprise, what human resource accounting is, which would be its implications and what are its main objectives.

Keywords: Human Resources Accounting, human capital, knowledge, intangible assets, Lev & Schwartz model

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1. Introduction

In recent years, the economic, political and social environment underwent profound changes that caused a higher level of globalization and an increasingly greater competition. Corporations have become increasingly strong and rising the problem of responsibility assuming, the companies have started to give increasingly more importance to corporate social responsibility. Customer expectations increased regarding product quality and environmental protection by producers.

We are in an unbelievable economic crisis, but this will end, sooner or later. It is therefore very important to know what role investment in human capital plays in solving this dilemma. In an economy based on knowledge, people being knowledge-holders become the most valuable asset of an organization⁶⁴².

In the economy of knowledge, there are the typical organizations developing, called knowledge or cognitive-intensive organizations. The term "knowledge-intensive" apply to organizations in which knowledge has more importance than other inputs and human capital predominates over other forms of capital⁶⁴³.

Specific to knowledge are two dimensions - human and economic. At company level, knowledge is reflected in the workforce (human capital), in the requirements and preferences of customers (customers as capital), in the products, processes, capabilities and its systems (structural capital). As a result, the value of knowledge assets can significantly exceed the value of tangible assets. Assessments of companies like Microsoft are telling in this regard.

⁶⁴² Nicolescu O., Nicolescu L.: Economia, firma și managementul bazate pe cunoștințe, Editura Economică, București, 2005.

⁶⁴³ Starbuck W.: Learning by knowledge-intensive firms, Journal of Management Studies, No.3, 1992.

2. Human resources. Most valuable asset of an enterprise.

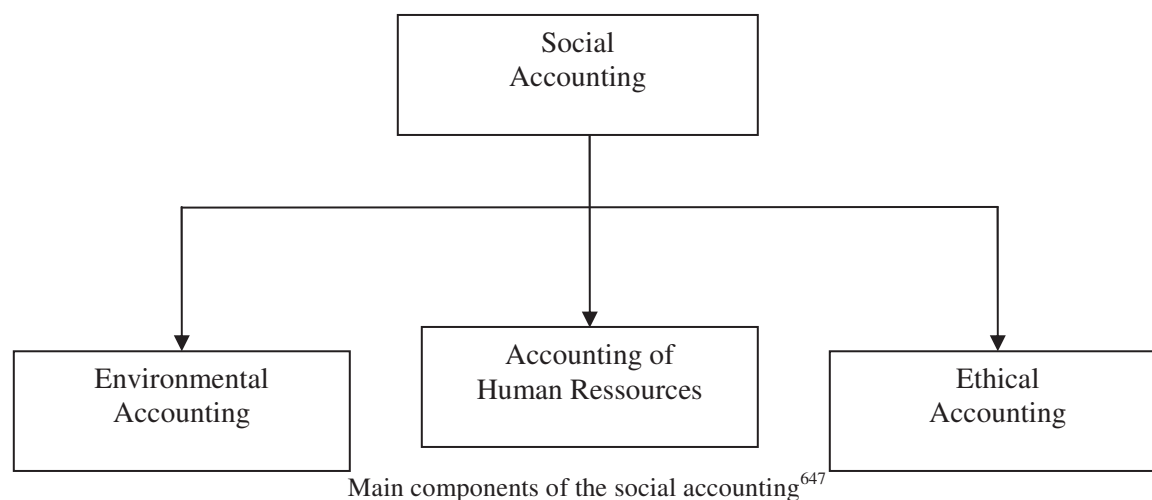
Resources are "all human, material, real and monetary elements that can be drawn and used in the production of economic goods to satisfy social needs"⁶⁴⁴. With the advent of the new economy, knowledge-based economy it has been concluded that human resources becomes increasingly more important in determining the total value of an organization. Human capital refers to a set of knowledge and competence, skills and training, innovation and capabilities, attitudes and skills, learning ability and motivation of the people who form the organization.

Although the technical installations, equipment or financial capital are important, human resources, in particular, very important⁶⁴⁵. Manolescu asserted that the traditional approach is to treat people as mere "expenditure" or in the accounting approach tendency as mere costs⁶⁴⁶.

Joint human resource paradigm is incomplete and limited. It takes your mind to a consumable resource type at a cost and therefore the administration in terms of minimizing costs. Actually it is about an essential strategic element in the company's future, it is about human capital. Human capital includes the combined knowledge, skill, creativity, resourcefulness and ability of each employee of a firm to conduct routine activities. It also includes the company's values, its culture and philosophy.

3. Accounting of Human Resources

Accounting of human resources forms direct part of the social accounting with the environmental and ethical accounting:



The American Accounting Association's Committee on Human Resource Accounting has defined Human Resources Accounting as the process of identifying and measuring data about human resources and communicating this information to interested parties. Human Resources Accounting, thus, not only involves measurement of all the costs/ investments associated with the recruitment, placement, training and development of employees, but also the quantification of the economic value of the people in an organisation⁶⁴⁸. Flamholtz⁶⁴⁹ too has offered a similar

⁶⁴⁴ Dobrota N. - coordinator: Dictionar de economie, Ed. Economica, Bucuresti, 1999, 159.

⁶⁴⁵ Armstrong, M., " A Handbook of Human Resource Management, Kogan Page, London, 2001.

⁶⁴⁶ Manolescu, A., " Human Resources ", Economic Publishing House, Bucharest, 2003.

⁶⁴⁷ Giju George Ciprian. Social accounting to make the social results visible, 2007.

⁶⁴⁸ American Accounting Association Committee of Accounting for Human Resources, Report of the Committee on Human Resource Accounting, 1973.

⁶⁴⁹ Eric G. Flamholtz: *A Model for Human Resource Valuation : A Stochastic Process with Service Rewards*, 1971.

definition for Human Resources Accounting. They define Human Resources Accounting as “the measurement and reporting of the cost and value of people in organizational resources”. Looking at different proposals⁶⁵⁰, 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) asset that an enterprise has is 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 difference⁶⁵¹

Characteristics of Human Resources Accounting:

- Its a system of accounting in which identification of human resources is made.
- Investment made in human resources is recorded.
- Measurement of costs and values are made.
- Changes occurring in human resources over a period of time are also recorded.
- Communicates information through financial statements to interested parties.

The main objectives of Human Resources Accounting are:

- Proper management of human resources
- Improvement of human resources.
- Depicting the true value of the organization.
- Provides quantitative information on human resources which helps the managers and investors in making decisions.
- Human Resources Accounting communicates the worth of human resources to the organization and to the public.

4. The treatment of Human Resources Accounting

According to Barcons et al⁶⁵² Human Resources Accounting can be treated from two perspectives:

4.1. Treatment from a Financial Accounting Perspective

Romanian accounting records to be kept in harmony with accounts in Class 4 Third party accounts and Class 6 expense accounts, namely:

- Group 42 “Personnel and assimilated accounts” (in which find both the accounting function of active accounts, the economic content of debt and liability accounts with the accounting office, the economic content of debt);
- Group 43 "Social security, welfare and similar accounts" (accounts with the accounting function of liability, the economic content of debts except the account 4382 "Other social debt "which has the function of active accounts, the economic content of debt);
- Account 444 "Tax on income from wages" account according liability account, the economic content of debt
- Group 64 "Staff costs" accounting with asset accounts function, uses economic content.

Following the definitions already explained, as long as future benefits are expected to come from these training costs, they can be treated as assets. However, this does not hold true in reality. As Cea García⁶⁵³ states: "There is a clear absence of correspondence between the real assets in the present firms and those recognised 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

⁶⁵⁰ Conner, K.: A Historical Comparison of Resource-Based Theory and Five Schools of Thought Within Industrial Organization Economics: Do We Have a New Theory of the Firm?," *Journal of Management*, 17, 1, 1991, 21-54.

⁶⁵¹ Archel, P.: Activos intangibles: análisis de lagunas partidas polémicas, Revista técnica del Instituto de Censores Jurados de Cuentas de España, 7, 1995.

⁶⁵² Barcons et al: Human Resource Accounting, *International Advances in Economic Research*, 1999, 386-394.

⁶⁵³ Cea García, J. L. "Las cuentas anuales y la imagen fiel," *Partida Doble*, 4, September 1990.

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 service 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 literature⁶⁵⁴. 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 expenses.

4.2. Treatment from a Managerial Accounting Perspective

Personnel working for a determined enterprise is actually participating in a value-creation process. That is, any economic activity makes the firm incur costs. One traditional classification takes into account the cost categories of raw materials, industrial plants, and personnel. When adding income flow to an organization's market goods and services, if it is superior to the cost flow, it becomes added value. This value is a consequence of the interaction between material and human resources in production. Because it is difficult to know and measure value, accounting has used substituted measures such as acquisition cost, substitution cost, and even opportunity cost⁶⁵⁵.

5. Methods/Models Of HUMAN RESOURCES ACCOUNTING

Many models have been created to value human capital. Some are based on historic costs while some are based on future earnings. But each has its own limitations and one model has proved to be more valid than other. In The following we will make a short description of the most important models of Human Resources Accounting:

Historical Cost Method. Actual cost incurred for recruiting, hiring, training and developing the human resources of the organization are capitalized and amortized over the expected useful life of the human resources.

Replacement Cost Method. This is the measure of the cost to replace a firm's existing human resources. This method has the advantages of adjusting the human value of price trends in the economy.

Opportunity Cost Method. In this method, the human resource of an organization has to be valued on the basis of the economist's concept of opportunity cost which is value of benefit foregone by putting it to present use.

Present Value Of Future Earnings Method. It recognizes an individual's expected economic value to the enterprise during his remaining service period. An estimate about the future earning is made, and these earnings relate to the period which extends to the date of retirement of the employees. Such earnings are discounted by an appropriate range to get the present value.

The Lev & Schwartz Model. The Lev and Schwartz model states that the human resource of a co is the summation of value of all the Net present value (NPV) of expenditure on employees. The human capital embodied in a person of age r is the present value of his earning from employment

Under this model, the following steps are adopted to determine HR Value.

⁶⁵⁴ Hendriksen, E. S.; Van Breda, M. S. *Accounting Theory*, Homewood, IL: Richard D. Irwin, 1992

⁶⁵⁵ Marqués, E. "Contabilidad y gestion de los recursos humanos," *Pirámide*, 1974

- Classification of the entire labour force into certain homogeneous groups like skilled, unskilled, semiskilled etc. and in accordance with different classes and age wise.eg. In Infosys the classification is based on software professionals & support staff etc.
- Construction of average earning stream for each group.eg. At Infosys Incremental earnings based on group/ age have been considered.
- Discounting the average earnings at a predetermined rate in order to get present value of human resource's of each group.
- Aggregation of the present value of different groups which represent the capitalized future earnings of the concern as a whole,

$$V_r = \frac{I(t)}{(1+r)^{t-r}}$$

Where, V_r = the value of an Individual r years old

$I(t)$ = the individual's annual earnings up to retirement

t = retirement age

r = a discount rate specific to the cost of capital to the company.

Critical appraisal of the Lev & Schwartz model:

- It is essentially an input measure .It ignores the output i.e. productivity of employees.
- Service state of each individual employee is not considered.
- The training expenses incurred by the company on its employees are not considered.
- The attrition rate in organization is also ignored.
- Factors responsible for higher earning potentiality of each individual employees like seniority, bargaining capacity, skill, experience etc. which may cause differential salary structure are also ignored.

Just like the environmental accounting, human resources accounting is necessary to get incorporated into the financial statements due to internal or management usefulness in taking decisions by potential users as well as externally for making decisions on staff by management. Accounting of Human Resources incorporates in the present financial statements of information on the assessment of one of the most important components of the organization, namely human capital.

In order not to conflict with International Accounting Rules we consider the easiest solution to be the legislation on the adoption of an annex to the annual financial statements that should include information about human capital, namely:

1. *Non-financial information:* leadership; motivation; ability of execution of delegated tasks; relation; number of employees; seniority in the company; stability in the company post; number of managers; number of women managers; percentage of managers with higher education; the average age of employees; the average length of training programs (hours/employee); IT knowledge.

2. *Financial information:* expenditure on advertisement for recruitment; cost of selection; training cost; on the job training cost; subsistence allowance; contribution to provident Fund; educational tour expenses; medical expenses; ex-gratia payments; employee's welfare fund.

As you can see all the individual capabilities, skills and experience of employees and management, creativity and spirit of innovation, investment in recruitment, selection, contracting, personnel qualification and improvement are included in the term of human capital. From the above discussions, it is felt that, Human resource accounting provides quantitative and qualitative information about the value of human asset, which helps the top management to take decisions regarding the adequacy of human resources. Hence, It is Concluded that, the Human Resources are an indispensable but often neglected element is thus to be foregrounded into the industrial area for the betterment of the economy.

Conclusions

The claims of the investors, the need for greater transparency and the free access to information, as well as the increasing of the value of intangible assets will make the financial report of companies have a much broader approach in the future. Thus, it could include the measurement of sustained effort, of corporate governance or human capital. The nature of the financial ratio will change in the future, as the importance of figures will not be the only aspect to consider. Thus, a financial report could measure human capital, the company's social responsibility or even carbon emissions.

Present accounting system ignores the importance of human resource value and Managers lack information about the effectiveness and efficiency of human resource investment. IASB treats most human capital related costs as expenses, instead of assets. The more the company invests in human capital, the less the current net income.

No model of human resources accounting is accepted by the accounting bodies all over the world. However, still we find some application of Lev & Schwartz model is most public sector units and IT based sectors. What is needed is measurement of abilities of all employees in a company, at every level, to produce value from their knowledge and capability. Human Resource Accounting (Human Resources Accounting) is basically an information system that tells management what changes are occurring over time to the human resources of the business. Human Resources Accounting also involves accounting for investment in people and their replacement costs, and also the economic value of people in an organisation

Recommendations:

- Use data and information on human resources costs to base internal decisions and their disclosure through an annual report of the organization;
- Treating investments in staff development at the same level with other investments;
- Treating costs like staff training and development as capital investment expenditures that increase the productive capacity of employees.

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