# Human Capital Accounting: Assessing Possibilities for Domestication of Practice in Nigeria

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**Abstract**

The paper aims at Assessing Possibilities for Domestication of HRA Practice in Nigeria, we review historical background of HRA and its current practices around the world in order to highlight some important lessons that cloud be learned by Nigeria as benefit or otherwise of HRA practice to the economy. The study utilized purely secondary data in form of journal articles, theses, dissertations and web-based materials. This paper discovered that, the existing accounting practice lack regard to human resource as an asset and that have significantly discouraged the use of any or a combination of measurement technique(s) in quantifying human resource let alone reporting it in Nigeria, it also established that HRA practice will enhance the completeness and quality of financial reporting in Nigeria by providing more information on the real value of companies to investors and other stakeholders for rational decision making. Moreover, the article concludes that, it is possible to domesticate HRA practice in Nigeria considering that, both professional and accounting standards are capable of accommodating HRA practices especially with the growth of service sector in the Nigerian economy and the manner in which convergence and harmonization of accounting practice grow stronger by the day. Finally we recommend for domestication of HRA practice in Nigeria through legislation and ensuring complete participation of all stakeholders, also international accounting standard (38) on accounting for intangible assets shall be expanded to cover human resource or there should be a new standard developed to carter for HRA practice in Nigeria.

**Keywords**: Human Capital, Human Resource Accounting, Cross-national comparison and Investment Decision

## Introduction

Human Resource Accounting (HRA) also tagged as Human capital or intellectual asset accounting is the process of identifying and reporting the Investments made in the Human Resources of an Organization that are presently not accounted for in the conventional accounting practices. In simple terms, it is an extension of the Accounting Principles of matching the costs and revenues and of organizing data to communicate relevant information in financial terms (Monti–Belkaoui and Riahi–Belkaoui, 1995).

The Quantification of the value of Human Resources helps the management to cope up with the changes in its quantum and quality so that equilibrium can be achieved in-between the required resources and the provided human resources. In effect, it is the assessment of condition of human resources within an organization and the measurement of the changes in the condition through time.

Human Resource Accounting provides useful information to the management, financial analysts and employees. Specifically, it helps the management in Employment and utilization of Human Resources and also in deciding transfers, promotion, training and retrenchment of human resources. It provides a basis for the planning of physical assets vis-a-vis human resources as well in evaluating the expenditure incurred for imparting further education and training of employees in terms of the benefits derived by the firm among others.

Approaches to Human resource accounting was first developed in the United States of America in the year 1691 the next stage was during 1691-1960 and third phase post-1960. There are two approaches to HRA. Under the cost approach, also called human resource cost accounting method or model, there are (a) Acquisition cost model and (b) replacement cost model. Under the value approach there are (a) present value of future earnings method, (b) discounted future wage model, (c) competitive bidding model represent prominent methodologies used in the practice of HRA.

Accounting practice is a universal language albeit not without variations from one society to another. This makes convergence and harmonization of accounting practice(s) almost inevitable noting the place of interdependence (global capital and expansion of same all over the world) in the era of globalization. In Nigeria, there is hardly available evidence that HRA practice has become part of the operations in defining accounting practice in spite of the sensitivity attached to Human capital in the process of production and management of organizations. Considering the pace at which globalization acquires greater significance by the day manifesting in the influx of global capital into the economy as well as growth of the service sector (Banking, insurance, consultancies etc) in Nigeria and also taking into cognizance the extent to which international best practices regulate corporate behavior, development of an avenue for the domestication of such a practice will prove useful.

This paper attempts to provide a conceptual framework on which the practice of HRA may be based in Nigeria.

**Human Capital Accounting: Conceptual Clarification**

Human Resource Accounting (HRA) has been defined by the American Accounting Association (AAA) as 'the process of identifying and measuring data about human resources and communicating this information to interested parties' (American Accounting Association, 1973). Contrary to the dominant image of human resource accounting as 'putting people on the balance sheet', the aim of HRA was wider. In fact, as outlined by Flamholtz (1999), HRA has three main roles: to provide organizations with objective information about the cost and value of human resources; to provide a framework to guide human resource decision making; and to motivate decision makers to adopt a human resources perspective.

Bhat (2000) provides a definition of "**HUMAN resources accounting**" as depicting the **human resources** potential in money terms while casting the organization's financial statements. The author refers to several measurement models including the Brummet et al. model (1968a, 1968b, 1969) based on historical cost method with provisions for appropriate depreciation and replacement cost of acquiring, training and developing the entire **human resources**, and competitive bidding proposing the capitalizing of the additional earning potential of each **human** resource in the organization.

HRA can be considered both an internal and an external discipline: internal as a management tool; external as a reporting tool. In HRA, human resources are viewed as assets or investments of the organization. HRA was originally defined as the process of identifying, measuring, and communicating information about human resources to facilitate effective management within an organization. It is an extension of the accounting principles of matching costs and revenues and of organizing data to communicate relevant information in financial terms (Flamholtz, Bullen & Hua, 2003). However, the process includes the concept of accounting for the condition of human capabilities and their value as provided by the measurement tools of the behavioral sciences. Human Resource Accounting (HRA) is a denominator (Frederiksen, 1998). Human resource Accounting (HRA) is concerned with measurement and reporting of the cost and value of people as organizational resources. HRA is basically an information system that tells management what changes are occurring over time to the human resources of the organization. In another development, Human resource accounting (HRA) is an attempt to identify , quantify and report investment made in Human resources of an organization that are not presently accounted for under conventional accounting practice (Tang,2005)**.**

Bhat,(2000) provides another definition as depicting the human resources potential in money terms while casting the organization's financial statements. The author refers to several measurement models including the Brummet et al. model (1968a, 1968b, 1969) based on historical cost method with provisions for appropriate depreciation and replacement cost of acquiring, training and developing the entire human resources, and competitive bidding proposing the capitalizing of the additional earning potential of each human resource in the organization. The author also mentions the Jaggi & Lau (1974) model estimating the human resources worth on a human resource groups basis with the groups accounting for productivity and performance, and Hermanson's (1964, 1986) un-purchased goodwill method in which the marginal higher earning potential of human resources in comparison with similar industries is capitalized. Bhat notes that with global trade and foreign exchange transactions becoming more complex with innovations in derivatives, more uniformity in accounting practices and transparency will emerge. The author suggests that accounting and financial management issues will soon be integrated in accounting statements facilitating more meaningful use of accounts, as opposed to history and bookkeeping.

Historically, HRA started in the 1960s with Hermanson (1964) first raising the issue of reflecting employees, an organization's most important assets, on the balance sheet. In the 1960s and 1970s there was a lot of interest in HRA, with the derivation of basic HRA concepts and the development and assessment of various human resource cost and value measurement models. The human resource cost approach involved measuring and capitalizing the cost of employees on the balance sheet with proposals based on historic cost, replacement cost, opportunity cost and, for sportspeople, contract costs. (Brummet, Flamholtz and Pyle, 1968; Flamholtz, 1973; Jaggi, 1974; Morrow, 1996; Flamholtz, 1999). Human resource value models included monetary and non-monetary methods of measuring the value of an organization's human resources, both at the individual level and at the group level (Lev and Schwartz, 1971; Flamholtz, 1971; Flamholtz, 1972; Likert and Bowers, 1973; Flamholtz, 1999).

From the above literature, it is essential to note that HRA is comparatively a new but a very sensitive development in the accounting field and there appears a somewhat consensus that its adoption is a response to the challenging questions posed by the prevailing trends that view human resource as most instrumental in production process.

**Human Capital Accounting Practices: A View from Cross-national Perspective**

In all parts of the world, some forms of practice of accounting are found. This does not necessarily imply complete uniformity noting that some aspects of the practice may obtain in one environment and fails to in another environment. On the basis of the foregoing, a parade of some countries will be undertaken with a view to exploring the accounting system and how the Human Capital Accounting acquires significance in the definition of their overall accounting practice. This will provide a platform for understanding the variation between the countries so paraded and Nigeria in the light of developed or adopted model and general orientation of the accounting system.

**Scandinavia**

The Scandinavian countries have taken a particularly strong interest in the area of HRA. For example, the Value Driving Talks (VDT) model was developed by Arne Sandervang (2000), and tested in an empirical study in a Norwegian business firm in the electrical sector. The model, which calculates financial returns on an organization's investments in competence development, focuses on employee training or competence development as its strategic focus, and aligns investment in competency development to the overall business strategy to help organizations with their strategic **human** resource management goals. The participants assess the benefits of the competency program through a benefit description statement that shows a comparison of the potential benefits and experienced improvements. A calculation is made of the benefits to the company and compared to the costs of training in order to arrive at the Return on Investment of training and development.

Two Swedish studies experimented with reporting HRA measures in financial statements. The Statement of **Human Resources**, published by Telia, a Swedish National telecommuting Company (Telia , 1996) and the Statement of **Human Resources** provided by the Swedish Civil Aviation (Swedish Civil Aviation Administration, 1998) provided some insights on the reporting formats. In case of Telia, in addition to a **human resources** report, the financial statements included a profit and loss account and a balance sheet that included investments in **human resources**. The statement provided by the Swedish Civil Aviation Administration provided the **human** resource income statement and a **human resources** balance sheet showing the change in the percent of value of **human** capital, number of employees and the calculated value of **human** capital, in addition to other key personnel indicators.

Roy (1999) reports on a case study on Skandia Group- one of the first companies known for its work on intellectual capital, and provides an interesting example for organizations desirous of managing their intellectual capital. Included in the case study is the process of development of the Skandia Navigator and the Dolphin Navigator under the guidance of Leif Edvinsson, one of the first persons to be documented as a knowledge manager, The Skandia Navigator successfully introduced new business ratios that emphasized an organization's intangible assets rather than tangible ones. The Dolphin Navigator developed was an IT infrastructure that would help to distribute information regarding Skandia Navigator business planning worldwide in a cost effective manner.

Grojer (1997) gives an interesting perspective on why HRA has taken roots in Scandinavia especially Sweden, as compared to other parts of Europe, by suggesting that **human** resource **accounting** measures can be successfully introduced only when it suits the social order in organizations—and Scandinavian management and the Swedish organizational social order suits HRCA. Grojer notes that introduction of new personnel key ratios in financial key ratio pages in organizations may result in the change in the social order between the management elite, and will therefore be a problematic process. A possible conclusion from this perspective is that **human** resource measures may be introduced smoothly in organizations when these measures would conform to the organizational social order, but that further research needs to study this area of HRA and social order in organizations in order to help us understand the full implications of this factor.

Olsson (1999) studied measurement of personnel through **human** resource **accounting** reports as a procedure for management of learning in the hospital sector of Northwest of Stockholm, and reported that learning in smaller groups is an effective means to make organizational communication regarding intellectual capital within the organization, helping organizations learn better on how to report **human resources** value. Olsson (2001) provided information on annual reporting practices related to **human resources** in corporate annual reports of major Swedish companies.

Vuontisjarvi (2006) explored by means of content analysis the extent to which the largest Finnish Companies have adapted socially responsible reporting practices in a research study focusing on **Human** Resource (HR) reporting in corporate annual reports with criteria set on the basis of the analysis of the documents published at the European level in the context of corporate social responsibility with special attention to the European Council appeal on CSR. The results of the content analysis indicate that although social reporting practices are still at an early stage of development in Finland, the most reported theme was training and staff development. A positive sign was that the majority also disclosed themes of participation and staff involvement and employee health and well-being, and nearly one third made references to their work atmosphere or job satisfaction survey. However disclosures lacked overall consistency and comparability with each other, and quantitative indicators were disclosed by few.

**United Kingdom**

Morrow (1996 & 1997) investigated the concept of football players in the United Kingdom as **human** assets and the importance of measurement as the critical factor in asset recognition. In another publication Wagner (2007) suggested that **human** capital (people and teams) is one of the intangible assets that investors look for in valuing a company, along with structural capital (processes, information systems, patents) and relational capital (links with customers, suppliers, and other stakeholders). Wagner notes that annual reports now overemphasize the role of relationship capital in company performance and minimize the role of **human** capital, giving a skewed view of companies' future performance. A conclusion was that the long-term value of innovative workers is not getting enough attention from companies preparing annual reports for investors, according to research for Britain's Economic and Social Research Council. Although the annual reports provide glowing accounts of R&D spending and numbers of patents, including those generated by the innovators have left the company, the reports are less likely to focus on the numbers of innovators that have left the company and have thus reduced the company's future prospects for innovation.

**India**

Interest in measuring **human** capital has also been apparent in India. Mahalingam (2001) notes that "Pundits of today assert that while the other forms of capital, including material, equipment, tools and technology, only represent inert potentialities, it is the **human** capital that converts this potential and energizes the creation of wealth." This author suggests a **human** resource value approach based on a person's skills and the returns these skills are expected to return over the next five years, with future years discounted to arrive at the current value. Mahalingam notes that each person has a set of competencies and a value is assigned to each, with the sum total of these values making up the value of the employee and the value of all the employees making up the **human** capital of the organization—which together with the customer and structural capital produces the revenue. In a case study conducted in India.

Patra, Khatik & Kolhe (2003) studied a profit making heavy engineering public sector company which used the Lev & Schwartz (1971) model to evaluate HRA measures. The authors examined the correlation between the total **human** **resources** and personnel expenses for their fitness and impact on production. They found that HRA valuation was important for decision-making in order to achieve the organization's objectives and improve output. The author also mentions the Jaggi & Lau (1974) model estimating the **human** **resources** worth on a **human** resource groups basis with the groups **accounting** for productivity and performance, and Hermanson's (1964, 1986) un-purchased goodwill method in which the marginal higher earning potential of **human** **resources** in comparison with similar industries is capitalized

**Canada**

Jones (2000) writes that "Financial reporting systems need to account for people. The author indicates that the issue of providing bottom line worth for training, wellness programs or employee satisfaction surveys remains an ongoing struggle with HR executives in Canada, and laments why one is required to make the business case for something that is intrinsically known to be important to financial importance. The author refers to the **International** **Accounting** **Standards** Committee (IASC) recently published standard on Intangible Assets (IAS 38) and comments on reports that investment and awareness of the importance of intangible assets have increased significantly in the last two decades.

Furthermore the author notes that while the standard is expected to have no direct impact on how Canadian chartered accountancy firms report and file (unless the firm is multi-national with offices in countries required to comply with IASC **standards**) it does give a global definition to intangibles. Jones also called for researchers to team up with practitioners to create the knowledge base required for the development of a whole new measurement system for value creation that would operate in parallel with the existing value realization measurement system. The author noted how the Canadian Performance Reporting Initiative Board is being established to advance knowledge in the intellectual capital management and other areas critical to performance measurement, providing a golden opportunity for HR leader to work together to ensure that people count in the preparation and reporting of financial statements.

**Nigeria**

 

Discussion on HRA practice in Nigeria can be observed based on contributions of both researchers and practitioners. The practice of HRA in Nigerian companies is more of a mirage than reality noting how human resource is not reported in financial statements. There have been little empirical researches on HRA related problems in the country. However, Okafor (2009) in her study on disclosure of human capital in the annual reports of firms in Nigeria, solicited for views of accountants both in academic and in practice. She posits that, most accountants are in favor of HRA theories and practice in the country, but they are of the view that, HRA information shall be presented as a separate report but as asset in the balance sheet so that financial statements without HRA information will look more healthier and they prefer staff costs method of HRA valuation for inclusion in financial statements.

The study discovered a number of difficulties in HRA which include; difficulty in quantifying human resource without bias, difficulty in establishing acceptable parameters for valuation, establishing basis for depreciating of human assets, high mobility from one job to other and agitation for salary increase can makes valuation difficult.

Kumshe (2012) in a PhD thesis titled human resource accounting in Nigeria; an analysis of its practicability which aims at examining and assessing the applicability of HRA in the financial statements of incorporated companies in Nigeria, he utilized view from both administrative and management staff of the sampled companies. The study established that, there is greater awareness among various categories of staff of HRA concepts but also agreed that HRA is not practiced by Nigerian companies. The study shows how HRA can enhance the completeness and quality of financial statements, also with HRA more information is made available to the investor to make more rational investment decisions, because HRA provides more information on the real value of companies.

**Methodology**

The paper applies a s methodology that allowed for review of historical background of HRA and its current practices around the world in order highlight some important lessons that cloud be learned by Nigeria as benefit or otherwise of HRA practice to the economy. The study utilized purely secondary data in form of journal articles, theses, dissertations, and web-based materials.

**Discussions**

The need for adoption of international best practices in the Nigerian accounting practice cannot be over-emphasized. This is given the universality of accounting the world over. Nigeria as an attractive economy in which a number of corporate wealth are established and with a considerable presence of development partners and bilateral organizations, depict a strong possibility for the adoption of such practices due largely to unification of operations in the case of corporate wealth and related investments. On the basis of the foregoing, the role to be played by both professional institutions/bodies and institutional frameworks remains incontestably central. Nigerian practice is lagging behind compared to other countries especially as same relates to proper quantification of human resource and reporting same in the financial statements of corporate citizens operating in the economy.

**Conclusion**

Lack of regard of human resource as an asset has significantly discouraged the use of any or a combination of measurement technique(s) in properly quantifying human resource let alone reporting it.

Considering the internationalization of various practices typical of corporate behaviors through the instrumentalities of international best practices, HRA is practicable in Nigeria. This is given the flexible nature of principles and rules guiding accounting profession in the country. Professional and related standards are also capable of accommodating HRA practices especially with the growth of service sector in the economy of Nigeria and the manner in which convergence and harmonization of accounting practice grow stronger by the day.

**Recommendation**

On the basis of the drawn conclusion, this paper recommends for domestication of HCA practice in Nigeria through legislation and ensuring complete participation of all stakeholders as this will help in strengthening investment and related decision, also international of accounting standard (38) on accounting for intangible assets shall be expand to cover human resource or there should be a new standard developed to carter for HRA practice in Nigeria.

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