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18th edition of the Conference "Risk in Contemporary Economy", RCE2017, June 9-10, 2017, Galati, Romania

Risk in Contemporary Economy

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Riana Iren RADU*, Iuliana Oana MIHAI, Violeta ISAI

https://doi.org/10.18662/lumproc.rce2017.1.11

How to cite: Radu, R. I., Mihai, I. O., & Isai, V. (2017). Considerations Regarding the Assessment Capacity and Recognition in Accounting of Human Capital. In S. Hugues, & N. Cristache (eds.), *Risk in Contemporary Economy* (pp. 135-145). Iasi, Romania: LUMEN Proceedings.

https://doi.org/10.18662/lumproc.rce2017.1.11

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International Scientific Conference Risk in Contemporary Economy | RCE 2017 | 9-10 June 2017 | Galati – Romania

Considerations Regarding the Assessment Capacity and Recognition in Accounting of Human Capital

Riana Iren RADU[1]*, Iuliana Oana MIHAI[2], Violeta ISAI[3]

Abstract

At present, human capital generates interest in the global economic system for both researchers and different organizations, having both favorable and unfavorable arguments for recognizing accounting and financial reporting. However, aspects regarding the human capital are not clear and there is no international convention to provide unitary regulatory practice. In this context, having as a source of information papers belonging to well-known authors, specialized articles published at national and international level, we have corroborated the essential ideas to highlight the human capital characteristics, surnamed "the new millennium currency", as component of human capital being considered the best asset of a company.

Keywords: *human resources, recognition, capital, intangible assets.*
JEL code: *M41, M51*

1. Introduction

This paper highlights some theoretical aspects of intangible assets, in general, and human capital, in particular, as a form of human capital that contributes to the effective fulfillment of the strategic objectives of the companies. The main models developed in the literature are presented to identify and measure human capital. The paper details the dilemma faced by the current economic environment regarding the recognition of human capital as an asset in the balance sheet.

[1] "Dunarea de Jos" University of Galati, Romania, raduriana@gmail.com
[2] "Dunarea de Jos" University of Galati, Romania, oana.anghel@ugal.ro
[3] "Dunarea de Jos" University of Galati, Romania, violeta.isai@yahoo.com

https://doi.org/10.18662/lumproc.rce2017.1.11
Corresponding Author: Riana Iren RADU
Selection and peer-review under responsibility of the Organizing Committee of the conference

Also, the paper includes theoretical aspects regarding the added value of human capital [1] aiming to verify the correlation between the performances of companies and human capital. We also looked at the disclosure of intangible assets and the difference between market value and booked value, the positive difference being attributed to a consistent but undiscovered human capital.

The research topic chosen in this scientific paper addresses the issue of capital in relation to the accounting information presented by intangible assets. The reasons for choosing this topic are multiple, as it follows:

It is kind of a new theme, with more and more researchers showing an increased interest in this topic.

It is a generous theme that can be approached from several perspectives.

There are few practical concerns about the recognition of human capital.

At international level, human capital research is expanding due to its major importance, being considered the most valuable asset of a company.

In this paper, human capital will be analyzed primarily as a stand-alone element, a component of intangible assets generating economic benefits to companies and leading to higher economic and financial performance, being considered as an indispensable element in ensuring the success of a long-term business.

2. Research methodology

In the context of globalization, the increase in competition and also the increase in investments on capital markets, managers may no longer be interested only in the cost and quality of products, but in the speed of operations and efficiency. Intangible assets have been extensively analyzed in the literature, in close correlation with the knowledge economy. However, the issue of intangible assets is far from receiving a uniform answer as to their economic nature, definition and classification, how they influence the value of the company, or the bases criteria of which these assets should be recognized and valued.

The term „human capital" was first used by Tom Stewart Fortune in a letter to economist Michael Kalecki in 1969. Tom Stewart is the author of the article "Brain Power - How Intellectual Capital Becomes America's Most Valuable Asset ", defining the human capital as the sum of all and of all those who form a competitive advantage in the market. [2]

Arvidsson [3] is in favor of the increase in importance of non-financial information on intangible assets [3], efforts made by companies to identify and explain the contribution of intangible assets to obtain high performance, and the need for voluntary reporting with regard to intangible assets aiming at diminishing the informational asymmetry existing in the traditional financial statements.

Also, Davey argues that in order to ensure the transparency of financial situations [4] and to gain the trust of stakeholders, it is mandatory to voluntarily return information on intangible assets, thereby exceeding the restrictions imposed by Accounting Standards.

A perspective of human capital that is intensively studied is represented by the recognition in accounting of human capital as a balance sheet asset. On the same tipic, a group of researchers from the University of Michigan has written a series of documents to expend the field of "Human Resources Accounting." In January 1967, an article was published in Harvard University, which deals with various methodologies for classifying human resources as assets, addressing the historical cost, replacement cost, and opportunity costs.

The effort to understand and measure the value of intangible assets reappeared almost 43 years later. Infosys, a company in India, measured the value of its human capital using a method developed together with professor Baruh Lev from Stern School of Business. [5]

At this moment, the biggest challenge is, by far, the consensual determination of the need for reporting human capital and the method used for reporting. [6] At the same time, there is little chance that the reporting of human capital will be standardized without the intervention of regulators (Guthrie and Petty, 2000). [7]

The major importance of human capital and its impact on company performance leads to the need to define a unitary reporting framework for human capital in particular, being considered the most valuable asset owned by a company.

3. Theoretical approaches to the active dimension of human capital

Human capital is assimilated to intellectual property, plus a series of nonspecific assets grouped under the name of intangible assets that contribute to the process of creating value added at the level of the economic entity. According to some authors, traditional accounting and financial systems have lost the ability to give information about the value of an organization that is increasingly given by intangible assets.

It is estimated that at this moment 60-70% of a company's value is given by intangible assets. Investments in intangible assets overcome considerably those in tangible assets, increasing the possibility of estimating as accurately as possible the value of a company.

Intangible resources are represented by reputation, product superiority, location, clients, creditworthiness and solvency to clients and banks, position towards public and administrative entities, technical, commercial and managerial competence. Resources that contribute to value creation can be grouped as follows: human, organizational, relationship, financial, and physical.

From an accounting point of view, the importance of intangible assets is insignificant, but the market value is 47% determined by the intangible assets held by economic entities. Market value is formed by the confluence of factors and is highlighted in Figure 1.

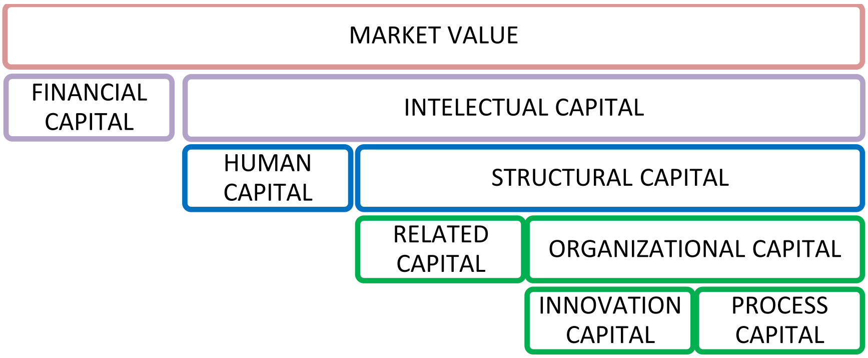

Figure 1 - The structure of human capital based on market value

Source: elaborated by the authors

Human resources, relational and organizational resources are part of the intangible resources category, while financial and physical resources are included in the tangible resource category. There must be a link between the two categories of resources, to be used interdependently in order to generate added value in the economic entity. Human capital has existed for a very long time; people who invented an alphabet, a calendar or the numbering system are the early owners of an extremely valuable capital.

Human capital has grown from the need to increase competitiveness [8] by making better use of intangible resources, such as knowledge, patents, brands, behavior within the organization, which has led to a considerable relationship between balance sheet value and market value. Financial capital is the measure of tangible assets, human capital designates employees in terms of knowledge, experience, and skills, while organizational capital represents an element belonging to the organization, which remains within the organization when employees leave the organization as computer systems and technology. The organizational capital includes the innovation capital formed by intellectual property and capital linked to production processes.

4. Human Capital Measurement Models - Intangible Asstes Monitor

Karl-Erik Sveby builds a model called Intangible Assets Monitor [9] used to measure and visualize human capital because he considers that disclosure of intangible assets raises the interest of two groups, as it fallows:

- External group, represented by clients, credit institutions or shareholders.
- Internal group, represented by management in order to correctly evaluate the company.

This model includes into the analysis the growth-renewal indicators, efficiency indicators, and stability indicators.

Indicators from the external structure area reveal that business professionals spend 90% of their time cooperating with their customers who they show a particular importance, being grouped into different categories. In this situation, all information regarding the change in structure of the customers can be analyzed and used in short time to assess potential for development of the economic entity.

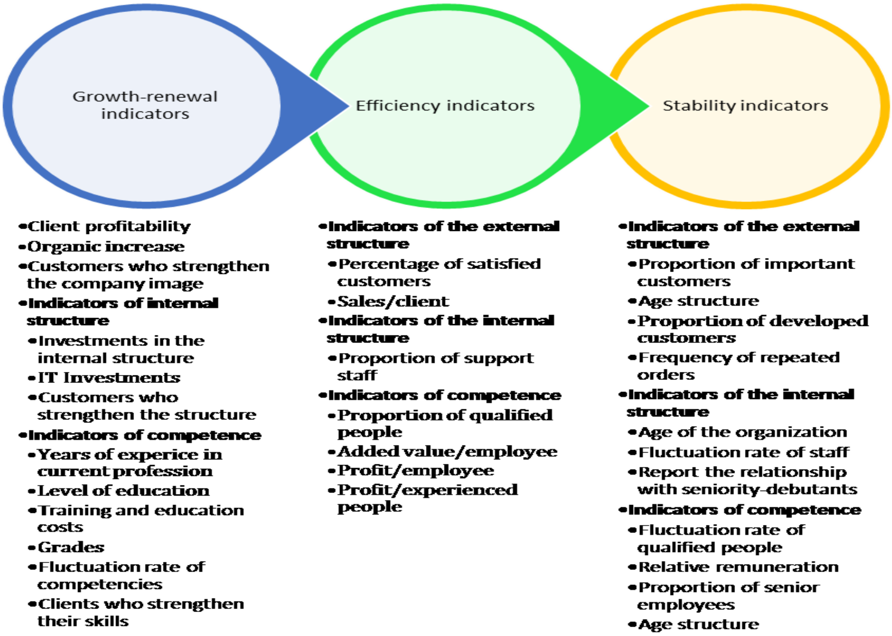

Figure 2 - The structure of intangible assets

Source: Information processed by the author based on Sveiby, K.E., A knowledge-based theory of the firm to guide in strategy formulation, Journal of intellectual capital, 2001

Regarding internal structure, Sveby uses the term support staff to name employees in accounting, human resources, management who have the role to maintain the internal structure of the entity. [9]

Growth-renewal indicators of the domestic structure include investments in new subsidiaries, which can be calculated as a percentage of value added. A well-known condition for business survival is investment in IT, being evaluated by the number of computers to the number of employees or the number of IT service packs per employee.

Discussing the competence indicators, Sveby considers that only experts within an organization have skills used to plan, produce and present products to the customer, the rest of the administrative staff being part of the internal structure as they carry out support activities such as reception, administrative and financial.

Thus, the age in the profession, the level of education, the training costs and the education are indicators whose analysis allows the assessment of the economic entity from the point of view of the employees' competencies.

Employee efficiency is determined by reporting the number of highly qualified professionals, to the total number of employees, with relevant comparisons being made between companies belonging to the same industry. Determining value added per employee, per professional as well as profits per professional gives important information especially to people outside the economic entity who do not have access to this information.

5. Models of measuring human capital - Balanced Scorecard

The model developed by Kaplan [10] suggests that an economic entity should be analyzed from four perspectives: the learning outlook, the perspective of internal processes, the perspective of the clients, and also the financial perspective. The ability of a company to manage intangible assets is more important for long-term success than asset management. Moreover, fixed assets will be exploited at a higher level if there is a better prepared workforce, a developed computer system and also a very good relationships with business partners.

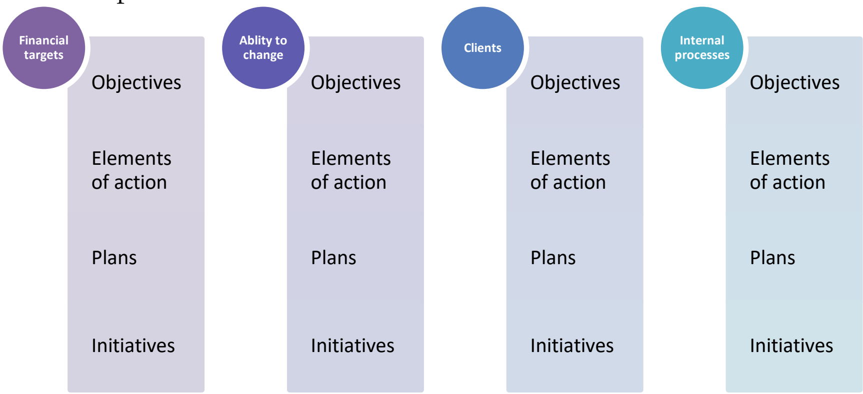

Figure 3 - Structure of intangible assets

Source: Information processed by the author based on Kaplan, R.S., Conceptual Foundations of the Balanced Scorecard Working Paper 10-074, Harvard Business School, Harvard University, 2010

The balanced score model provides valuable information that, effectively used, leads to the discovery of those forces that provide superior performance and future successes, strengths that are intangible in nature.

6. Identifying Human Capital - Possibilities of Recognition in Accounting

From the intangible asset category, there are assets that can be recognized in financial statements [11], such as trade marks, patents, but there are also assets that can not be recognized in financial statements such as human capital, long-term expenses other than the purchase of fixed assets by the firm in order to improve its results.

According to the MAGIC model (Measuring and Accounting Intellectual Capital)[12], human capital consists of four subdivisions:

- Market assets, represented by trademarks, market segments, order reservations, distribution channels, assignment contracts, licensing or franchising. Efficiently used, such assets create competitive advantages on the market;
- Infrastructure assets such as technologies, technical processes, working methodologies to ensure effective running of the company;
- Intellectual property assets, such as: copyrights, software, patents, know-how, techniques, manufacturing secrets;
- Human values, represented by employees' professional skills, including experience, ability to solve problems, leaders.

These values are crucial to the company because it is costly to engage, form and maintain at a high level these values. Studying this way of classification leads to the conclusion that we can look at human capital as an internally generated fund that has the role of creating additional market value as well as helping the company in the future generating economic benefits.

On the other hand, the International Accounting Standard IAS 38 "Intangible Assets" states that internally generated assets cannot be capitalized and will therefore not be disclosed in the enterprise's financial statements. As we can see, human capital does not just refer to the existence of assets, values or resources, but also includes the organization's ability to turn one resource into another. Only the presence of resources does not generate value. It is important how these resources are highlighted, and especially how one resource is transformed, so a solution should be found to make these resources available.

The accounting profession has not adequately developed tools to address structural change in the new economic landscape. Traditional accounting methods [13] have been designed to consider tangible assets, such as a depreciated manufacturing facility, which is related to historical cost. Since intangible assets are not easy to measure, such as a company's brand, measurement and pricing can be difficult. Many people can use this as an argument against the creation of updated accounting standards. The new rules could offer companies the opportunity to manipulate their financial statements under the excuse of valuing intangible assets.

The primary purpose of the financial statements is to try to accurately describe the economic reality of a company and provide users with relevant information to enable investors to make the right decisions regarding their investments. A reporting system that fails to provide information on the underlying issues leads to the idea that a company's ability to properly inform is missing or is deficient. People invent products of drugs designed to ameliorate certain diseases, but all this value is under-represented because people are an "invisible" and unquantifiable asset. Human capital can be characterized and defined as abilities, skills, training, education and the experience of individuals [14]. A key factor in moving towards recognition as an asset of people is the value of an employee who can appreciate with training, engagement and teamwork, all the investments that are essential to firms in the 21st century. [14]

Intangible assets are recognized as an important component that leads to high business performance. However, the same as for any other assets or resources, there are difficulties in identifying how these assets are properly accounted. Unlike other types of assets, human capital raises questions. In addition, human capital is not easy to quantify. Lev (2000) notes that intangible assets are valuable sources and provide a competitive advantage, so there are assumptions to overcome the accounting recognition test. [5]

The reason for companies to provide information on human capital [15] is generated by:

- the desire to describe the hidden values of human capital that companies hold but which they do not present in financial statements;
- the desire to establish a dialogue with the public about corporate values, management and the attitude of its employees;
- the desire to raise the company profile by describing the key competencies of its employees;
- the desire to present the results of its efforts to its employees, for example through comparative analysis and comparison with other enterprises

In the literature, there are several studies based on the evaluation and recognition of human capital, social capital, human capital, resulting in the need for a unitary image of investments made in human capital. Some research included human resources accounting issues with the purpose of examining and comparing reporting practices across multiple countries.

Human capital problems can include effective leadership, recruitment of key people, major training programs, or performance-based payment for employees. Significantly, we also have to take into the risk of presenting such information that must be neutral, irrelevant and complete, including both positive and negative aspects. Companies need to invest in education and training as employees have to develop continuously throughout their lives, the higher the investment, the higher the results on all levels.

7. Conclusion

In conclusion, regardless of the benefits that human capital provides to the company and its major role under current rules, it cannot be included in the financial statements, and the only possibility is that it is presented as non-financial information to show the added value it brings to the enterprise.

Human capital and, implicit, human assets represent a category of assets which raises controversy over the nature of the regulation both for regulatory entities and for the main international accounting norms. The current accounting rules are limited in terms of recognition and valuation of the intangible asset. On the other hand many of the solutions proposed to solve the "intangible asset" issue are based on providing additional information about the intangible asset in the annual report, being necessary to achieve international convergence, organizations operating both at national and international level feeling the lack of adequate accounting regulations.

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