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Historical Cost Method in Human Resource Accounting: An Evaluation

Felix Osayabor Emovon
Department of Accounting,
Igbinedion University, Okada, Edo state, Nigeria.
felix.emovon@iuokada.edu.ng

Peter Okoeguale Ibadin
Department of Accounting,
University of Benin, Benin City, Edo State, Nigeria.
okoeguale.ibadin@uniben.com

Abstract

This study investigated historical cost method in human resource accounting: An evaluation. Human resources, a crucial asset for any organization, play a significant role in business and the economy. Human resource accounting is a relatively new concept that has grown in prominence in financial statement preparation around the world. The historical cost technique is one of the most popular methods because, like standard accounting procedures, it calculates an employee's worth using the whole historical expenditures associated with hiring an individual. This strategy necessitates accounting for the cost of the staff investment. One of the drawbacks of this strategy is that it requires decisions on which costs to expense and which to capitalize. The objective of this study is to examine historical cost method in human resource accounting. The methodology adopted for this study is library approach which focuses on the review of the extant literature on historical cost method in human resource accounting. It was observed in the literature that human resources are critical assets to the organization and significant in the generation of value. To this end, the human resources should be capitalized rather than expensed on the financial statements. The study concludes that human resources are the most valuable asset that an organization may have. Such critical resources, which require significant capital to generate future streams of income, should be recognized as an intangible asset rather than expensed on the statement of comprehensive income. Because human resources are critical to the value creation process and a source of long-term competitive advantage, accounting bodies should create a generally accepted basis for valuing, recording, and disclosing human resources accounting information in an organization's financial statements. The study recommends that historical cost method in human resource accounting should be adopted by organizations as this is already used in the statement of profit or loss and is easy and aligns the historical cost nature of the financial reports.

Keywords: Human Resource Accounting, Historical Cost Method, Organization and Valuation.

Introduction

Human Resource Accounting (HRA) is an accounting tool designed to account for people as organizational resources by providing stakeholders with information on the estimated value and cost of human resource investment in an organization. It was created to address a flaw in the traditional accounting system, which writes off all investment in human resources as expenses in the year they are incurred. Human resource accounting assesses an organization's human resources in a methodical manner and records them in a financial statement or annual report to communicate their value, changes over time, and results achieved from their usage to financial statement users. The significance and need for human resources Accounting as a technique of appraising human resources has been widely recognized, and it is progressively being used in many nations, despite the constraints. (Islam et al, 2013). The application of human resource accounting varies across organizations and countries (Boedker, et al, 2008) Swedish models are used by businesses to assess and report on certain of their intangible assets, such as intellectual capital and human resources. United Kingdom determines value and reports on its intangibles through a business committee of practice called MARIA (Managing and Reporting Intangible Assets). Among the nations recognized for HRA is India. According to the literature, some organizations in the nation's public and private sectors are interested in the financial worth of their human resources. (Pandey, 2014 & Orjha, 2013).

According to Flamholtz (1971), Williams Petty established the first human resource accounting firm in the United States in 1691. He made the first attempt in 1691 to put a monetary value on human beings. According to Petty, labor is the source of wealth and should always be taken into account when estimating the total wealth of a country. Among other scholars, Far in 1853 and Engle in 1883 made additional efforts.

The rigorous assessment, documentation, and presentation of human resource value in an organization's books of account is known as human resource accounting. The process of locating, quantifying, and informing interested parties about human resources (assets) is known as human resource accounting. Organizations will be able to decide appropriately on both internal and external issues as a result. Human assets have the same capacity to generate income and expenses as other physical assets. As a result, it is essential to value human resources equally with other assets, that is, to weigh the advantages and disadvantages of human capital. (American Accounting Association, 2014). Human resources can be referred to as human assets or capital; these refer to the set of individuals, who make up the workforce of an organization or a business entity (Edom et al., 2015; Syed, 2009).

Economists use the term "human resource" to refer to human capital, which is viewed as a production factor. They investigate various methods of quantifying the investment made in human capital in areas such as health and education. These resources, which are operational factors on an organization's performance, are as implicit knowledge in employees. (Hajkarimi, 2009). The historical cost method, which determines an employee's value using the total historical expenditures related to hiring them, is one of the more widely used approaches due to its resemblance to standard accounting procedures. The cost of the employee investment must be accrued when using this method. This method's decision-making over which costs to capitalize and which to expense is one of its drawbacks. To help with decision-making, human resource costs can be divided into two categories: training and education. This method would involve accounting for all training expenses related to the present position. Anything related to preparation or advancement would be considered an educational expenditure, and these expenses would be capitalized. (Dawson, 1994).

Among others, Flamholtz (1999), Pyle and Brumnet (1968) contributed to the establishment of the historical cost technique. The true cost of human resources is taken into account in this model. The following elements are included in such a cost: Acquisition Cost is the sum of money spent on hiring and choosing. It is significant to remember that the expenses associated with recruitment and selection will document the entire process for those who are ultimately hired. One of the factors that contributes to the value of human resources is learning cost, which is the total cost of training and development. Welfare Cost is made up of all the cost of catering for the needs of human resource which is made up of cost such as canteen bill, health insurance, security cost etc. The historical cost model has its benefit, its simplicity however, this model does not fully capture the potential of an employee in monetary terms.

Completeness is one of the best qualities of quality financial information because incomplete information can be even more damaging than none at all. The demand for an accounting standard pertaining to the measurement, disclosure, and presentation of human resources makes sense. (Akintoye et al, 2016). This is to guarantee that the financials accurately reflect human resources and provide all relevant data, enabling the financials to be used to make meaningful decisions. Furthermore, the various approaches to human resource valuation can make it simpler to manipulate financial records, which might have disastrous consequences for the company, its investors, other stakeholders, and the environment at large. Consequently, using a common model is required. In actuality, to lessen inclinations toward manipulation in the financial report preparation. To this end, this study will theoretically investigate the adoption of historical cost method in human resource accounting: an evaluation

Literature Review

Human Resource Accounting (HRA)

Flamholtz et al. (2002) defined human resources/capital accounting as the accounting of individuals as an organizational resource. It entails calculating the expenses incurred by firms when recruiting, selecting, hiring, training, and developing human resources. According to Newman (1999), human resources accounting is the measuring of all employees' capacities at every level of a company-management, supervisory, and regular employees-to produce value from their knowledge and mental powers.

The American Accounting Association (2014) defined human resources accounting as the process of identifying and measuring data about human assets (resources) and communicating this information to interested parties. This will enable organizations make relevant decisions regarding internal and external matters. Like physical assets also have the ability to create expenditure and income. Therefore, it is necessary to value human forces just as other assets that is to consider the costs and benefits of human resources. Rensis Likert, a social psychologist, is credited with coining the term "Human Assets" in the late 1950s, which later researchers replaced with the term "Resources." This study is the source of human resource accounting. His work's fundamental idea was the accounting phrase for the human resource expressed intuitively. Likert's ideal was developed during a period when societal norms were shifting generally and behavioral issues with the accounting system in particular were becoming more widely recognized (Akinsoyinu, 1992).

Human resource accounting, according to Fajana (2002), is a response to the criticisms that the traditional accounting system is inadequate for the needs of a large number of users, and that the custom of treating all expenses related to the formation of human capital as an immediate charge against income is not consistent with how comparable expenditures on physical capital are treated. Flamholtz et al (2003) utilized the HRA measure of expected realizable value, and found that employees' participation in management development program increased the value of the individuals to the firm. In addition Flamholtz noted that the human resource accounting measures provided upper level management with an alternative accounting system to measure the cost and value of people to an organization. The impact of human resource cost metrics on bankers' decision-making was examined by Schwan (1976). He discovered that two statistically distinct estimates of the company's net income and one considerably different assessment of management's readiness to face future opportunities and challenges were produced by the inclusion of human resource accounting data in public financial statements.

Historical Cost Method

The historical cost method model proposed by Flamholtz (1999) incorporates actual expenses related to hiring, training, and development that are part of the historical cost approach. The organization's human resources are capitalized, amortized over their anticipated useful lives, and part of their income is written off during the following few years that they will be used to provide services. Appropriate documentation of the hiring, selection, training, and development of the workforce is also maintained. The entire sum that is not written off in the event of an early liquidation of human assets is charged to income for that year. The amortization schedule may need to be revised if the useful life turns out to be longer than anticipated. Human resources have historically cost around the same as the book value of the other tangible assets. In the same way that adding to a fixed asset increases its value, hiring an employee comes with the clear expectation that his contributions will outweigh the costs associated with selection, development, and training. These additional costs, which are capitalized and amortized over the employee's remaining life, are also associated with training and development. The investment in human capital has an unexpired value. Historical cost method as opined by Dawson, (1994) is one of the more popular methods because of its similarities to normal accounting procedures, it calculates an employee's worth using the total historic costs associated with obtaining an employee. This method requires accruing the cost of the investment in the employee. One of the problems with this method is that decisions must be made about what cost to expense and what cost to capitalized. One way of deciding what to expense or capitalized is to classify human resource costs as either training or educational. This method would involve accounting for all training expenses related to the present position. Capitalization would be applied to the education expenses related to the advancement or preparedness.

Flamholtz (1999) proposed that the historical cost technique capitalizes all costs related to hiring, training, and recruiting and amortizes them over the asset's estimated life. Flamholtz asserts that an individual's value is determined by the current value of the services they are expected to provide to the organization in the future. This view is shared by other researchers (Akintoye, 2012). The model postulates that as an individual moves from one position to another, either at the same level or at different levels, the profile of the services provided by him equally change. Thus, the value of individual to an organization is taken to be the present cumulative value of all the possible services rendered by such an individual.

The concept of historical cost is a fundamental principle in the field of accounting. It mandates that reporting entities must assign a value to their assets based on the original acquisition costs, specifically the amount paid to acquire and utilize them (IASB). One of the notable advantages associated with the utilization of historical costs in the valuation process is the inherent constancy of the cost. This characteristic allows reporting entities to readily substantiate the value assigned to an asset or liability at any given point in time. One notable benefit associated with the utilization of the historical cost approach is its widespread acceptance as a reliable method for valuing and documenting financial transactions, as highlighted by Akintoye et al, (2018). Historical cost are readily comprehensible by various parties, including management, financial report readers and other stakeholders (Arkan, 2016).

Gogo (1987) elaborates on the Historical Cost Method, describing it as an effort to adhere to the fundamental ideas of traditional accounting. According to Gogo (1987), the total cost of recruiting, choosing, acquiring, familiarizing, and developing the various employee grades inside a business is the worth of human resources in this context. This approach was classified as an Outlay-Based Approach by Craft and Birnberg in their 1980 study. They clarified that the majority of the early work in human resource accounting focused on monetary outlays spent on building human assets in order to determine organizational expenditures in people. The historical cost approach was defined as the capitalization of the company's out-of-pocket expenses for acquiring and developing its human resources (hiring, selecting, and so forth) for each individual. Akintoye (2012) used Oceanic Bank PLC as a case study to investigate the relevance of human resource accounting to effective financial reporting. The Lev and Schwartz model was used to determine the value of human resources, and simple linear regression was used to analyze the impact of human resources on effective financial reporting by combining investment in human capital, profitability, and capital employed. The researcher examined secondary data from Oceanic Bank PLC's annual reports and accounts between 2002 and 2006. The data reveal that human resources have a beneficial effect on the bank's profit and capital employed.

According to Arkan (2016), the notion of human resource accounting remains theoretical, with little real-world application. The report recommends the creation of a comprehensive framework to help integrate human resource accounting practice. This idea is based on the belief that issuing a specific accounting standard for human resource accounting would effectively encourage consistency and uniformity in the disclosure of HRA data. In light of this, the study recommended that the historical cost technique be generally adopted in the valuation of human resource accounting because it is currently used in the profit and loss statement, is simple, and aligns with the financial report's historical cost character. Also, this method is simple and meets the traditional principle of accounting i.e. matching of cost with revenue and the historical cost of human resources is almost like the book value of the other physical assets.

CRITICISM OR WEAKNESSES OF SUBSISTING HUMAN RESOURCE ACCOUNTING (HRA) METHODS

No single approach or technique for valuing human resources in a company can meet all organizational and professional goals. Firms that produce commodities differ from those that provide services, and it may not be possible to apply the same Human Capital Accounting methodologies to both. For example, in an auditing firm, a member of staff may be measured by the number of invoices generated in a month, however in a manufacturing industry, an employee cannot be directly identified with the finished product because such items travel through numerous hands and units. There is also concern that Human Capital Accounting could be utilized by management to skew financial results. With the failure of Enron, WorldCom, and many other companies as a result of so-called creative accounting, many believe that Human Capital Accounting will provide management with an avenue to falsify financial statements. Assigning value to employees may become a poor motivator for those who place a higher value on their jobs than management does (Gebauer, 2023).

Some e.g (Oluwatoyin, 2014; Roslender, 2004) also criticize strongly the documentation of people as book assets. Their argument is that it presents employees as property of an organization. Evaluation in Human Resource Accounting requires a lot of estimations of data which is susceptible to manipulation. Management could manipulate figures to suit its interest. Jasrotia (2004) also examined trends in the field of human resource accounting and identified certain barriers to progress and use of the idea. Such factors include a low degree of understanding and acceptability of human resource accounting compared to the adoption of International Financial Reporting Standards (IFRS). IFRS were adopted in Nigeria in 2010.

Managers may utilize human resource accounting (HRA) to manipulate employees. He or she may reduce the value of an employee as a means of punishment or control. This can be accomplished by adjusting variables such as the likelihood of an employee being promoted to the next level, future increments, and so on, which determines the worth of human resources. If the employee's value was known, his or her bargaining power could improve (Ratti, 2012).

Flamholtz (1999) clearly identifies the key challenges in the field of human resource accounting as valuation issues, inherent uncertainty about the value to be included in the financial statement, and the possibility of fraudulent manipulation. Sveiby (1997) observed that, while some organizations measured their human resources, they did not include the value in the annual report as assets, stating that such activity is unnecessary given the existing accounting concept, which lacks a model, norms, and laws for this type of reporting. Furthermore, firms are hesitant to disclose too much information. Edward and Garyl (2001) both recognized the slow evolution of the concept of documenting human resource worth. According to them, this is primarily due to the lack of proved effectiveness in the accounting profession.

SUGGESTIONS TO IMPROVE HISTORICAL COST METHOD IN HRA

Human resources are widely regarded as an organization's most significant asset. It is the driving force behind the creation of goods and services. They also have a huge impact on the performance of every organization. However, its inclusion in corporations' financial statements has been harshly criticized in several places. It is interesting to note that all valuation methods have certain disadvantages or limitations, coupled with the fact that it is argued that human capital accounting may be used by management to manipulate financial statements or employees. However, applying the historical cost method in the valuation of human resource accounting can be a plus for the organization and its stakeholders. To this end, we are of the opinion that human resources should be capitalized rather than expensed on the financial statement and that historical cost method in human resource accounting should be adopted by corporate organizations, considering the enormous benefit it will accrue to an organization.

We further suggest that management should apply historical cost method in human resource accounting as this is already used in the statement of profit or loss and other income statements and to consult HRA specialist to coordinate the whole process and model for human resource accounting measurement in the organization also a follow up staff should continue the process and provide a proper auditing to avoid manipulation.

Financial Reporting Council of Nigeria (FRCN) and other relevant agencies should consider the possibility of an accounting standard for human resource accounting measurement and valuation. This will enhance valuation of human capital, ensure a higher degree of utility to stakeholders, uniformity in disclosures and allow a reliable comparison of human capital values.

The historical cost method in human resource accounting should be adopted by organizations as this is already used in the statement of profit or loss and other income statement as it aligns with the historical cost nature of the financial report.

Conclusion

This paper examined the historical cost method in human resource accounting. In achieving this objective, a library approach was adopted to review prior investigation. In the cause of the review, it was observed that historical cost method could be adopted in the valuation of human resource. This is because human resources is found to be the most valuable asset an organization can possess. Such vital resource with huge capacity to generate future stream of incomes should be treated as an intangible asset rather than expensed in the statement of comprehensive income. For the fact that the human resource is fundamental to the value creation process and a source of sustainable competitive advantage the accounting bodies should develop a generally accepted basis for valuation, recording and disclosure of human resources accounting information in the financial statements of an organization and that there is a great need for evolving a system of accounting for human resource that is acceptable to professional accountants, managers and other stakeholders.

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