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Conflicting conceptualizations of human resource accounting

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Abstract

Purpose – The purpose of this paper is to examine the differing perceptions or conceptualizations that have contributed to prevailing views held by accountants on the measurement and reporting of human resources.

Design/methodology/approach – The study provides an analysis of extant literature and presents a theoretical framework on the relationship between HR, intellectual capital and goodwill.

Findings – The lack of traction in the progress of accounting for people is due to several factors including tension between employees and management, the demands of internal and external stakeholders, and the historic roots of accounting for labour.

Research limitations/implications – The paper provides suggestions as to how the debate regarding the valuing and reporting of human resources may be rekindled.

Originality/value – This study highlights the historical context for the lack of traction in the area of accounting for people, and the relatively recent development of the Intellectual Capital Statement as a partial but positive development in the area.

Keywords Human resource costing, Human resource accounting, Human resources, Human capital, Intellectual capital, Goodwill

Paper type Conceptual paper

1. Introduction

Firms, particularly those that are publicly listed, are under constant pressure to provide accurate financial information to shareholders and stakeholders at large. Faced with these pressures, the field of accounting has had to confront the difficult territory of intangible asset recognition and measurement. Such issues have impacted on, for instance, demands to produce information relating to corporate social responsibility (CSR). This has led to the development of CSR reports and metrics, such as the CSR scorecard, that focus on aspects that previously were not deemed appropriate or even considered as relevant to the financial status of the firm. Examples of companies that produce such material include the multinational automobile manufacturer Nissan (www.nissan-global.com/EN/COMPANT/CSR). Accounting information users have arguably benefited through the acquisition of more accurate information to support managerial decision making, such as assessing acquisition possibilities.

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Likewise, widespread discussion about the so-called knowledge economy has opened up the "black box" of intellectual property to incorporate intellectual capital as an asset for company reporting purposes – in addition to patents, trademarks and brands (Guthrie, 2001; Mouritsen *et al.*, 2004; Roslender 2009a, b). Flamholtz *et al.* (2003) note this increased emphasis on intellectual capital as a factor in the development of the intellectual capital statement. Accounting information users have arguably benefited through the acquisition of more accurate information to support managerial decision making, such as assessing possible acquisitions. This information has a role therefore in adding to the value and relevance of financial and managerial accounting.

The one area that remains elusive though is the treatment of "human resources". The sub-field of human resource accounting (HRA) – that Roslender (2009a) refers to as "accounting for people" (AFP), and Guthrie and Murthy (2009) as human competence accounting (HCA) – addresses the difficulties of determining the most significant elements of employee worth (Roslender and Dyson, 1992; Mayo, 2005; Verma and Dewe, 2008). As we will discuss later, despite the concerted effort of such advocates, there appears to be a continual lukewarm reception within the broader accounting and finance profession to the "human resource" question. A common argument is that measuring human assets involves more subjectivity than measuring other physical assets, and precludes treating them as assets and reporting them in financial statements.

Given that intellectual capital has been recognised as a key reporting component, one would assume that interest would have moved beyond such debates. After all, widely accepted definitions of the concept of intellectual capital include human capital and thus it is integral to any attempts to report the true value of a corporation's intellectual capital (Mouritsen *et al.*, 2001). Our review of relevant literature, however, suggests that general interest remains focused on debating measurement issues, such as whether to capitalise or expense investment in human resources, and whether human resources qualify as assets in an accounting sense. Moreover, the debate that has become almost circular in nature: we recognize the existence of intangibles but cannot agree on their relevance in terms of accounting-in-practice. This lack of "traction" is particularly evident when it comes to valuing human resources.

In this paper, therefore, we identify and discuss three sets of differing perceptions or conceptualizations that have contributed to views regarding human resources: financial accounting's approach compared with that of managerial accounting; differing ontological foundations between the accounting and human resource management (HRM) scientific disciplines; and fundamental differences between corporate management and employees as to the value of the human contribution to organizational performance. We then contrast the approach taken towards accounting for goodwill, an intangible that is now identified as a valuable asset with appropriate metrics. We conclude with suggestions on how the debate may be rekindled, building on the current work on reporting intellectual capital.

2. Layers of conflicting conceptualization

Existing literature points to several sources of conflict that have permeated the discussion of accounting for human resources. Naturally these are not mutually exclusive but act as a form of reinforcement to existing perceptions. The layering effect,

we suggest, contributes towards to the observed lack of traction, or seeming indifference.

Financial accounting versus managerial accounting

The focus on measurement and quantification of human resources is understandable with the roots of accounting in source disciplines such as economics and scientific management. However, while financial and managerial accounting have the same roots, they are usually treated as quite distinct areas within academic circles. The increasing emphasis on intellectual capital in the recent HRA literature may reflect the ascendency of financial accounting as a sub-discipline. For example, there have been several papers in the *Journal of Human Resource Costing & Accounting* recently that deal with issues of intellectual capital and some that relate specifically to intellectual capital statements from an external reporting perspective (Joshi *et al.*, 2010; Whiting and Miller, 2008).

Flamholtz, arguably the most influential contributor in this field, has consistently acknowledged the importance of accounting for human resources as a management tool (Roslender, 1997). Nevertheless, HRA's association with financial accounting remains dominant, as indicated by the research focus on financial accounting and reporting. The development of the intellectual capital statement goes some way to providing information potentially useful to both external and internal stakeholders.

Number Cruncher's versus Bleeding Heart's

Our sub-heading reflects an oft-expressed description of accountants and human resource professionals. Naturally, it reflects the primary roles these position holders play within Western corporations and their respective job responsibilities. But there is a difference in professional training that complements philosophical approaches and attitudes towards valuing human resources related to the two separate disciplines. In a survey of business professionals, Kahn *et al.* (2010) found HR directors generally held more supportive views of workforce health and wellbeing as a valuable organizational asset. Accounting and finance professionals employed in private sector organizations were the least enthusiastic about such issues.

Covaleski and Aiken (1986, p. 308) consider that "no theory gave greater impetus to the need for accounting in organizations than Taylor's scientific management". Coupled with the influence of economics as a source discipline for modern business approaches, emphasis is placed on monetary measurement, leading to a dominance of financial reporting in the context of firm efficiency, performance measurement and managerial control (Hopper *et al.*, 2001; Maher, 2001). This emphasis on monetary measurement has not always extended to human resources.

After the abolition of slavery in the nineteenth century, it became morally repugnant to talk of accounting for human assets. It is not unexpected therefore that it took a long time to return this topic to the accounting agenda. There is a sense of irony here in that humans were removed from financial statements during the emancipation debates in the eighteenth century, but the absence of the human contribution to the firm's production as reported in the financial statements may have made the acknowledgement and rewarding of workers' contributions all the more difficult. The modern debate post-Second World War initially centred on whether humans could be classified as assets; this, no doubt, was influenced by earlier eighteenth- and nineteenth- century ideals. The fact that the cost

of labour is expensed rather than recognized as an asset could be seen to coincide with the consumer model of modern capitalist economies.

As with accounting, HRM as a scientific field of inquiry shares a common influence from economics and scientific management thinking. For example, the resource-based view (RBV) of the firm has emerged as a dominant school of thought. A central plank of RBV thinking is how certain inimitable, rare and unique resources may provide the corporation with competitive advantage (Verma and Dewe, 2008). One such resource is people, a perspective that has influenced the sub-field of strategic HRM that has sought to enhance the standing and value of the field of HR. Within strategic HRM, there is considerable literature addressing how human resource practices contribute to productivity and firm performance (Boxall and Purcell, 2000). However, there is a lack of definitive evidence to show that such a contribution can be effectively measured (Bowen and Ostroff, 2004). So, while accounting and HR may share a common theoretical base, there are differing assumptions about people. This is perhaps best exemplified through language: accounting literature traditionally uses the term "human assets" whereas the term "human resources" was chosen to replace "personnel" as the designated title of those delegated responsibility for employees within firms, and this changed terminology spilled over into academia in the 1980s. Both accounting and HR now appear to be comfortable with the term "human capital".

Despite these apparent differing perspectives, HRA/AFP/HCA indicates how seemingly separate professional concerns may coalesce in the search for a solution. Traditionally, accounting has emphasised reporting and managing non-human capital through the development of rigorous structures, metrics and policies. Likewise, HR has endeavoured to demonstrate the economic benefits that accrue through improved training and related HR systems and practices. Indeed, HRA/AFP/HCA may be seen as an attempt to improve managerial decision making through more accurate information, while simultaneously providing HR managers with supporting data to further develop human resources. While some within HRM circles are open to such attempts, others are more cautious, arguing that to adopt metrics such as ROI to measure human contribution may be counterproductive and it could lead to the demise of the HR profession (Pfeffer, 1997). Thus, the wisdom of adopting a more economic (profits through people) and less welfare-orientated (profits and people) perspective has been questioned (Rynes, 2004).

The emergence of sub-fields such as HRA/AFP/HCA illustrates how knowledge migrates across the somewhat artificial edifices erected by scientific disciplines. Scholars "borrow and refine ideas" (Daft and Lewin, 2008, p. 170). HRA is perhaps an example of this as proponents seek ways of determining the most significant elements of employee worth (Roslender and Dyson, 1992). Those within the field of HRM may relate to the concept of "soft accounting numbers", and applaud attempts to demonstrate "human value accounting" as worthwhile (Roslender, 1997, pp. 10-12).

Management and employees

Another area that may explain the seeming indifference to developing appropriate measures for valuing human resources is that of the differing perspectives of management and its workforce – perhaps illustrated most vividly by an adversarial industrial relations system that continues to persist in Anglo-US firms, or through managerial rhetoric failing to live up to expectations. The almost ubiquitous statement in most large Western-based, publicly listed, corporations' annual reports is that

"people are our most valuable resource", yet firms facing economic difficulties tend to reduce their training programs and/or reduce employee numbers as a cost-cutting exercise. It is notable that the majority of Western corporations remunerate top management on the basis of financial measures, such as share-market performance, rather than by less quantifiable intangible aspects, such as quality of decision making or protection of its stock of intellectual capital.

Traditionally seen as responsible for employee welfare, the HR department has been affected by global trends such as the devolution of HR responsibilities to line managers that began in the 1980s, the increasing outsourcing of more traditional HR activities (e.g. selection and training), executive coaching by outside parties, and employee engagement provided by corporate communications and marketing executives (Welbourne, 2011). One consequence of these changes is a diminishing of the perceived status of HR as a functional area. A dilemma for HR practitioners then is that of being essentially the proverbial meat in the sandwich – representing the workforce as well as being part of the senior management team. It is notable that Peterson (2004) attributes the growing influence of HR professionals on managerial decision making to the gradual decline in unionism in the USA.

In dealing with workplace relations, of course, one has to acknowledge the impact of cultural factors that have differentially shaped business thought and practice in North America, the UK, Scandinavia and Europe. The vast literature on cross-cultural management and comparative HRM demonstrates how workplace relations are a function of socio-cultural attitudes, beliefs and values. In turn, these shape thinking about managerial approaches to individuals' contributions to organizational outcomes. For example, the scientific management school of thought has been influential in developing US managerial thinking: its underlying premise that "Every man has his price" is evidenced in time and motion studies, and piece rates to increase productivity. In contrast, in France and Germany, management thinking has been influenced by the administrative management school (e.g. Fayol's principles of management stressing unity of command, fair compensation, stability of tenure, *esprit de corps*, and initiative) and Weber's concept of bureaucratic man with the emphasis on aspects such as the separation of office and incumbent, promotion on merit, and universally applied rules. Scandinavian firms embraced concept of semi-autonomous work groups as an alternative to production lines.

Apart from work design, country differences are revealed in the collaborative approaches: the German use of two-tiered governance boards with worker representation; and worker representation in decision making in Scandinavian firms. What is also notable from our cursory analysis of the literature is that valuing people may have found more resonance in Scandinavia (as demonstrated by the contributions of Gröjer, Johanson Mouritsen and Sveiby amongst others) than in other countries. Could it be that the disclosure of the worth of employees threatens to shift the balance of power in countries such as the USA, the UK and Australia, whereas such a fear may be less in the more collaborative system? If so, then it may explain the reluctance of those working within an adversarial system to embrace concepts such as HRA and the intellectual capital statement.

Dumay and Lu (2010) provide a case study of the human capital disclosures of an Australian bank. They highlight how highly exposed such disclosures are to scrutiny by both internal and external stakeholders. They propose that if the rhetoric contained

in such disclosures is not transformed into practice then adversarial stakeholders can use it to attack the organization and/or attempt to change the balance of power between management and employees.

Roslender and Stevenson (2009) discuss an event in the UK which provides an illustration of how controversial human capital reporting may be. In 2003, the UK Government commissioned a task force on human capital management to identify measures used in practice to assess human capital investments, to consider the best practices in human capital reporting and to champion widespread human capital reporting. On the basis of the taskforce's recommendations a proposal for making such human capital-based reporting mandatory was passed into law in the UK on 22 March 2005. Later in that year the Chancellor of the Exchequer intervened and removed the mandatory provisions for human capital-based reporting. Roslender and Stevenson (2009, p. 861) observe that the repealing of the legislation for human capital reporting in November 2005 "genuinely shocked interested parties [. . .] and led to widespread criticism." This sudden repealing of provisions that would mandate greater disclosures has been interpreted as an attempt to placate the accounting profession, particularly auditors (Roslender and Stevenson, 2009). Work by Foong *et al.* (2003) may shed some light on why business and the profession opposed such disclosures. They suggest human capital information may lead to undesirable consequences, such as enhanced bargaining power for unions and employees due to a greater awareness of their significance to the firms; and evidence of their importance in wealth creation. These conclusions are supported by critical accounting theory which posits that accounting numbers that simply quantify events are used as a tool by the owners of capital to subjugate labour (Deegann, 2009; as cited in Samudhram *et al.*, 2010).

Verma and Dewe (2008) used a survey questionnaire to identify and describe perceptions and practices in valuing human resources in various types of UK organizations. While the majority of respondents regarded the measurement of human resources as important to their organization, either little or moderate progress was expected to occur in the acceptance of measurement practices over the next few years. These authors listed the main reasons for this as: lack of organizational support; uncertainties as to what should be reported; lack of precision in current measurement practices; and sensitivities around what should be reported.

What is noticeable is that, perhaps as a reaction to their seemingly lower positions *vis-à-vis* their managerial colleagues, some HR professionals have, like many in accounting, seized on the concept of human capital as an integral element of intellectual capital. An excellent illustration comes from a job title provided in the editorial of an issue of the US-based *Human Resource Management* journal (Welbourne, 2011, p. 168): "Head of human capital strategy & workforce analytics". Lawler III (2009, p. 1) refers to the human capital-centric organization as a source of competitive advantage. He observes how "Unlike experts in finance and experts in accounting, experts in HR typically are not on [company] boards". In fact, the US Sarbanes-Oxley Act requires all US publicly listed companies to have a financially experienced and qualified board member; no such requirement yet exists for HR.

3. Human capital and goodwill

As mentioned earlier, a desire to incorporate intellectual capital seems to have added further to the discussion regarding the measurement of intangible assets. What can

be overlooked in the discussion is that accounting has grappled for many decades with intangible assets measurement. The adoption of the concept of goodwill is instructive in that business has long recognized the limitations of operating solely on the use of tangible, financial statements for decision making and evaluating the true worth of an enterprise. While goodwill has traditionally been considered hard to measure and difficult to account for (Sundararajan, 1995), this has not prevented its adoption as an acceptable reporting practice.

The accounting literature has never explicitly excluded people from the understanding of what constitutes goodwill. One of the earlier writers on the subject (Leake, 1930, p. 18) unambiguously includes people in his definition of goodwill: "any or all such property as business connection associated with names, *persons* [our italics] and places of business, trademarks, patents and designs, copyright and the right to exercise monopolies". Later, Gynther (1969, p. 248) proffered an all-inclusive definition: "goodwill would be the net present value of those assets that it has not been possible to cost and value separately". A contemporary view regards goodwill as the value ascribed to intangible assets including reputation, a well-trained workforce, good contacts within the industry, favorable business location, and other unique features of the company for which another company would pay a premium over the net assets (or fair value of net assets) reported in financial statements (Seetharaman *et al.*, 2006). The human element is clearly part of any purchased, i.e. formerly internally generated goodwill. It is true, however, that IAS38 continues to explicitly prohibit internally generated (non-purchased) goodwill for reporting purposes – the argument being that the purchase crystallizes the value via the transaction, in line with the realization axiom. There are of course methods for valuing internally generated goodwill but this example serves to illustrate the issues around placing people on the balance sheet. It is also easy to see how such a "catch-all" definition came to be used as a substitute for intangible assets.

The traditional employment contract legally specifies the transaction between employer and an external party (the employee). As such, it identifies the job-related skills, experience and knowhow that the appointee brings to the organization; that is, their intellectual capital. One of the consequences of opening up the "black box" of intellectual property has been the discussion of how to acknowledge the value of intellectual capital. This has spawned a stream of literature covering a range of areas, such as: the impact of reporting intellectual capital in various industry settings (Bukh and Jensen, 2008; Buszko and Mroziewski, 2009; Cañibano and Sánchez, 2009; Kamath, 2008); the relationship between intellectual capital reporting and firm value (Whiting and Miller, 2008); the impact/importance/usefulness of intellectual capital from a capital markets perspective (Abhayawansa and Guthrie, 2010); aspects of intellectual capital reporting by commercial banks (Joshi *et al.*, 2010; Khan and Ali, 2010); and quantification of information related to intellectual capital included in annual reports or prospectuses (Rimmel *et al.*, 2009). A significance of this literature is that it demonstrates how certain properties of intangible assets can be quantified.

A second consequence is that the pressure to consider intellectual capital has required its clear definition. Guthrie (2001) stresses that the definition used by the OECD carefully distinguishes between the overall intangible asset base of a business, and intellectual capital which is considered as a subset of the former. The OECD considers intellectual capital to comprise two elements: the structural (such as proprietary software,

organization routines, and supply chains) and the human (individuals' knowledge, capabilities). Thus, the evolving understanding of the concept of intellectual capital has prompted rethinking about the nature of intangible assets. Intellectual capital is no longer regarded as a synonym for intangible assets (Guthrie, 2001).

Although tightening definitions result in conceptual clarification, it perhaps exposes more difficulties due to the dual nature of the resource in question: human beings. That is, by differentiating intellectual capital as a sub-set of intangibles, attention has shifted the spotlight back on to human capital. The conundrum this poses is that of measuring human capital. As Ehrlich and Murphy (2007, p. 1) remark: "Human capital theory is one of the most universally accepted concepts in economics and other social sciences". However, devising even approximate metrics is complex due to its very nature, and it is not surprising that it is generally the least disclosed among the intellectual capital categories as defined by the OECD (Abhayawansa and Abeysekera, 2008). For example, in Finland, human capital-based external reporting has been attributed to only about 20 percent of private companies (Ahonen, 2009; Ahonen and Grö, 2005).

Human capital is a concept that attempts to encapsulate the individual (the micro level) and the aggregate (the firm). Discussion around measuring human capital tends to focus on the sum of a firm's stock of human resources: a combination of individuals' knowledge, skills, and abilities, without a clear understanding of what each individual contributes or the effect that exit of key individuals may have on the aggregate stock at any point in time. Head counts can provide only a partial picture as the individual can decide when and how personal human capital is utilized. It is this property of human capital that makes it a difficult concept to operationalize and thus measure. Human capital only describes part of a firm's human resource base, and organizational human capital is invariably greater than the sum of its parts. A multi-level model of the human capital resource, in which individual level attributes emerge as valuable unit-level human resources, has been proposed by Ployhart and Moliterno (2011) but the challenge remains of how to measure the relevant conceptualizations. "Human capital is seen as the primary determinant of productivity" (Dess and Shaw, 2001, p. 447) and it is linked to investment in training, retention and other management practices that may lead to improved productivity. Of particular significance in a dynamic competitive environment is the finding that human capital contributes to a manufacturing firm's competitive advantages by enhancing the firm's flexibility (Jin *et al.*, 2010).

Accounting for intellectual capital therefore needs to take into consideration the dual nature of human resources. As can be seen from Figure 1, human resources contain an element of intellectual capital and an element of goodwill; a duality that is reflected in the OECD definition of intellectual capital and the generally accepted notion of acquired goodwill.

4. Concluding remarks

It is evident from our analysis that proponents of AFP continue to struggle to gain sufficient acceptance to challenge prevailing paradigms. It begs the question: if a composite concept like goodwill can be recognized, measured and reported – albeit imprecisely – and become accepted practice, why has it been so difficult to devise a similar way to value "human assets"? We suggest the following factors may shed some light on why the issue fails to generate a more enthusiastic response.

First, the seeming reluctance to account for the worth of human resources is not the sole preserve of the finance and accounting profession; senior management also play a significant role in how corporations approach reporting accountability. For example, based on his study of informal information flows, Macdonald (1996, p. 221) observes:

> The large firm copes best with familiar information, with codified information, flowing in a regular format from expected sources to determined destinations along established channels. There are routines and procedures for such information[. . .]

Accountability requirements imposed by the centre upon subsidiary units at the periphery generally take the form of "highly codified financial information delivered in a form that can be instantly understood and directly used by the centre". Macdonald then quotes a company interviewee: "I think there is little doubt that the structured information, the financial stuff, is definitely at the forefront" (p. 223). Such actions reinforce the importance of what is considered as objective, factual data upon which managerial decisions can be made and justified. It may also partially explain the lack of acceptance by accounting practitioners of intellectual capital statements and the like.

Second, as the issue has implications for both financial and managerial accounting, it is claimed by both "sides", contributing to the lack of traction we have identified. Theoretical debates and paradigmatic positioning, however, are of peripheral interest to practitioners. This is not to say that attempts have not been made to devise appropriate metrics. For example, it is four decades now since Lev and Schwartz (1971) proposed a value-based model for valuing human resources that was able to assign probabilities of exit together with probabilities of promotion, mortality and future wages.

Third, as noted earlier in this paper, intangibles are complex and valuing human resources is a contentious issue. It is understandable that some in the profession find it easier to concentrate on more mainstream issues such as the harmonization of international accounting standards. However, management deals in information and requires appropriate techniques (Roslender, 2009a). Requests to value intellectual capital to meet mandatory reporting requirements may be a powerful catalyst, mirroring the introduction of accounting for goodwill.

Fourth, if we overlay the historic roots of accounting with past debates on emancipation and the moral repugnance of placing human life on the balance sheet, we can understand the philosophical reluctance of many to certain aspects of accounting for human resources, at least in the early days of the discipline. This may go some way to explain the traditional accounting treatment of expensing the cost of labour but not recognizing it as an organizational asset. However, the lack

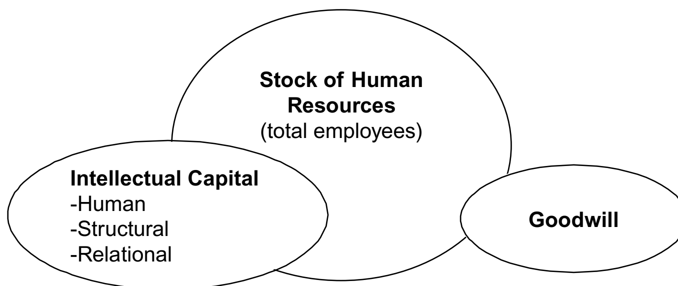

Figure 1. Human resources, intellectual capital and goodwill

of widespread adoption of highly prescriptive numerical metrics may be a blessing in disguise. In their seminal work, Gröjer and Johanson (1988) warned that without diligence the potential benefits of HRA could be reduced if procedures become captive to rigid procedures.

In conclusion, we suggest that the debate regarding the measurement and reporting of human assets is far from over. A concerted effort is needed to resolve past conflicts and move ahead on the basis that the fundamental principles of accounting of relevant, timely and accurate information to serve the needs of stakeholders. A more informed discussion may be possible through a comprehensive meta-analysis of research in the area including publications concerning AFP, to identify possible gaps, potential areas of conflict and direction for future research. It could also confirm the influence of national culture on how people are valued and reported.

By recognising at least part of the contribution that people bring to the firm, we can move the debate towards a more holistic assessment of "human resources". While there may be difficulties in producing the precise metrics beloved by many in management circles, at least taking into consideration intangibles, albeit imprecisely defined and measured, may assist in improved decision making that is based on a more accurate picture of the firm's worth.

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