Woman C.P.A.

Volume 39 | Issue 1 Article 7

1-1977

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Clara C. Lelievre

Jacob B. Paperman

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Editor, Dr. Clara C. Lelevre, CPA
University of Cincinnati
Cincinnati, Ohio

Guest Author

Dr. Jacob B. Paperman, CPA, is a member of the faculty of the Department of Accountancy at Miami University and has had articles published on current value accounting, cost accounting, and human resource accounting in various professional journals. He is a member of AICPA, AGA, AAA, NAA, and the Ohio Society of CPAs.

The Current Status of Human Resource Accounting

Although the theory of Human Resource Accounting (HRA) was developed by Roger H. Hermanson in 1964, the subject received little attention outside of academic journals until the summer of 1969. At that time, HRA was introduced to practicing accountants with the announcement that the first such system had been initiated at the R.G. Barry Corporation. During the following years, the innovators of the R.G. Barry installation (Brummet, Flamholtz, Pyle, and Likert) authored numerous articles regarding this experimental application. They predicted that HRA, in addition to being a useful management tool, would ultimately be reported in audited financial statements and prove to be important information for investors.

In the ensuing years, HRA received considerable attention regarding its theoretical usefulness to managers and the propriety of including such information in the published financial statements. The Touche, Ross and Co. Montreal Office reported experimenting on an internal application. Several articles also indicated that experiments had been conducted by banks and a study of force-loss cost analysis had been conducted at the Human Resource Laboratory of the American Telephone and Telegraph Company. The facts disclosed about the R.G. Barry system and the other internal programs were limited to general comments and suggestions about improved reporting of personnel turnover. Few, if any, factual statements have appeared about other attempts to test or implement a Human Resource Accounting System.

The best summarization of the results of internal applications of HRA appeared in Flamholtz's book, *Human Resource Accounting*. In addition to applications that had been reported in the literature, Flamholtz discussed his efforts to develop pilot systems for an insurance company and the CPA firm of Lester Witte & Company. The results reported indicated existing difficulties in determining the value of the services of employees, obtaining acceptable mobility data, and a need to change the valuation model being tested. Apparently, the American Accounting Association's 1974 Committee on Accounting for Human Resources was dissatisfied with the paucity of reported results. The Committee expressed the opinion that few companies were ready to establish a human resource accounting system because no financial benefits had been demonstrated. It further suggested that the few companies that had attempted such programs had not published the results of the experiments because they were unsuccessful.

Since little was published on the status of HRA applications, the author initiated correspondence with several major industrial firms, national CPA firms, and the American Institute of Certified Public Accountants. From the replies received and an interview with the Treasurer of the R.G. Barry Corporation, Mr. Richard Burrell, facts were obtained about the current status of HRA in both internal and external reporting systems.

Internal Applications

Thirteen companies (figure 1) reported (in an unpublished doctoral dissertation) to have experimented with an internal application of HRA were queried in late March of 1976 on the status of the project and information regarding the published or unpublished results of the experiment. As of July 1976, seven firms had replied. Three of this group indicated their activity had been limited to financial support of the project at the University of Michigan, inquiry of interest in the program, and provision of data to a dissertation candidate. One company indicated no record of any participation in the project while the remaining three that reported participation stated the effort was primarily involved with personnel activity and not integrated within the accounting system. Two of the companies that had participated reported that the analyses of the results indicated that many questions must be answered before their efforts could be applied to a routine accounting operation. It was also stated that the experiments had been halted pending further research on the basic concepts and problems of allocation and measurement.

HRA in Financial Statements

Twelve national certified public accounting firms (figure 2) were queried to determine if they had any established policy or research on the subject of HRA. Five companies sent written replies and two others gave negative answers during a telephone follow up. The only firm that had a stated policy was Arthur Andersen & Company. Respondents from three of the firms gave their personal opinions that HRA was unacceptable under APB No. 17.

Arthur Andersen & Co. had presented its policy on HRA in *Objectives of Financial Statements 1972.* In this publication, the firm established that an asset should have the characteristics of utility, scarcity, and exchangeability. In accordance with these criteria, the paper concluded that tangibles such as human resources and goodwill are not assets. However, it recognized that for some companies the charging of large expenditures for human resources to earnings on a current basis may distort income reported in the short term. A solution to this problem would be to report such expenditures separately on the income statement and possibly include a statement of intangibles supplemented with a narrative of important facts. Thus, while the human resources and other intangibles are eliminated from the balance sheet, the information is made available to the external users so they may judge management's performance in this critical area.

A leading proponent for the external use of HRA, Marvin Weiss, has inferred that the capitalization of training by Electronic Data Systems, the Milwaukee Braves, and Flying Tigers are examples that the concept of HRA has been considered and accepted in the past. The Braves and Flying Tigers had ceased this procedure in 1964 and 1969 respectively, a period before HRA was even discussed in accounting literature. The R.G. Barry Corporation, the only company to present pro forma HRA statements in its annual reports, discontinued the HRA system in 1974. This action was taken because the top management of the company was of the opinion that the firm did not possess the resources necessary to accomplish the continued development required for HRA to become an effective management tool at the operating level. Mr. Burrell was of the opinion that the concept is valid but will not move towards general acceptance until the basic theory is more clearly stated, the measurement problem is solved,and the information provided is demonstrated to be reliable. These actions are not expected to receive any attention until the more pressing problems such as leasing and accounting under inflation are resolved by the FASB.

Figure I
Firms Questioned
On HRA Experience

American Airlines
American Telephone & Telegraph
The Budd Company
General Motors Corporation
General Telephone & Electronics
Mobil Oil
PPG Industries
Rockwell International
Sherwin-Williams
Texas Instruments
Uniroyal
Western Electric
Westinghouse Electric

Figure 2
National CPA Firms
Queried on HRA Policy

Arthur Andersen & Co.
Ernst & Ernst
Alexander Grant & Co.
Haskins & Sells
Hurdman & Cranstoun
Laventhol & Horwath
Main LaFrentz & Co.
George S. Olive & Co.
Peat, Marwick, Mitchell & Co.
Price Waterhouse & Co.
Touche, Ross & Co.
Arthur Young & Co.

With the discontinuance of HRA by the R.G. Barry Corporation it appears that actual implementation by industrial firms has ceased as no record could be found of any company, in the United States or Canada, that was utilizing an HRA system and/or reporting HRA information in published financial statements. This was supported by a study of the utilization of HRA in the professional sports industry by Philip E. Meyer in 1973. This study revealed that the sports industry, a prime candidate for HRA, had no general techniques to measure or report the cost of human resources. The general lack of interest in HRA in published statements is further evidenced by Gyan Chandra's study of the information needs of security analysts which disclosed that HRA information was the item considered least useful in the investment decision.

Several of the major arguments against the use of HRA in financial statements are:

1. Human resources do not meet the criteria of ownership required of an asset.
2. Reporting of humans as assets would have an unfavorable effect upon employee morale.
3. The measurement of the value of human assets is entirely subjective and incapable of verification.
4. Expenditures for specific training measurement of human asset value are either unacceptable under the theory of HRA or Generally Accepted Accounting Principles (GAAP)
5. The information would be misleading or confusing to the readers of financial statements as they have had no experience or standards upon which to evaluate the data.
6. No operational system exists for implementation.
7. Accounting must resolve other and more pressing problems.

The counter arguments for HRA generally include:

1. Accounting in respect to leases stresses the economic substance rather than the legal form.
2. No evidence exists to prove reporting an employee as an asset will be dehumanizing and several motivational theories suggest it may prove beneficial.
3. Accounting information should be relevant with less stress on objectivity and verification.
4. Expenditures for specific training will produce future increases in profits, and to expense such items is a violation of the matching principle.
5. It is the accounting profession's responsibility to introduce new practices to improve the relevance of the reports and to educate the users of the reports regarding the implications of the changes.
6. The continued use of the principles of conservatism and refusal to capitalize human resource expenditures results in an over-statement of future income and

a false appearance of improved operations.

Summary and Conclusions

The theory of HRA is based on elimination of ownership as a prerequisite characteristic of an asset and the utilization of value accounting. This theory was brought into an operational installation through Rensis Likert's, a behavioral scientist, attempt to integrate HRA with his concepts of participatory management. The system that was initiated at R.G. Barry in 1966 was designed for internal usage. However, the company reported the results in pro forma statements in its 1969 through 1973 annual reports. These statements carried the following note because it was recognized that HRA was not inherent in generally accepted accounting principles.

The information presented on this page is provided only to illustrate the informational value of human resource accounting for more effective internal management of the business. The figures included regarding investments and amortization of human resources are unaudited and you are cautioned for purpose of evaluating the performance of this company to refer to the conventional certified accounting data further on this report.

Although several valuation models have been developed, measurement is still the primary obstacle to an effective application of HRA. None of the cost models proposed are in conformity with the economic valuation concept of the theory. None of the economic models recommended are acceptable under generally accepted accounting principles. In addition, none of the models have yet been tested to the extent required to ascertain their reliability or usefulness.

The final results of the initial applications of HRA for internal usage have not been adequately reported for analysis by the profession. In addition, neither the AICPA nor the CICA has considered the subject of sufficient importance to study its possible application in published financial statements. Apparently, Arthur Andersen & Company is the only national CPA firm to have established a policy regarding human resources. It has recommended that human resources should be excluded from consideration as assets as they lack exchangeability. If the reporting of large expenditures is necessary, Arthur Andersen recommends that it be accomplished in a special statement.

For each argument against HRA's extension to financial statements, a counter argument exists. The basic issues center on the definition of an asset, use of current value accounting, objectivity, problems of measurement, and the usefulness of data. The accounting profession's current lack of agreement on the objectives and basic principles of accounting is the primary hinderance to the acceptance of HRA and any theory formally derived through deductive reasoning. In the almost 500 years since Pacioli wrote the *Summa,* accountants have still not been able to agree on such a basic issue as the definition of an asset.

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