Emerging Markets Queries in Finance and Business

Accounting for soccer players: capitalization paradigm vs. expenditure

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Abstract

During the last century, football has evolved from a noble sport – played for reasons of entertainment, to a real money-making industry. This paper aims to analyze the reason of this evolution through the accounting point of view. More precisely, the paper presents the economic impact of football, how players’ contracts registration is framed by human resource accounting field, how accounting techniques can influence a club’s financial representations, which International Accounting Standards are applied on football players’ contracts and how can their articles be interpreted. Moreover, the paper studies the accounting and valuation of different types of football players, based on their entry in a football team’s squad. Finally, the main goal of the paper is to show which accounting and valuation technique is the most appropriate, in order to present „a true and fair view” in the financial statements.

Keywords: football; contract; license; information asymmetry; valuation; financial reporting

1. Introduction

The modern business world is constantly changing and its expansion is affecting many aspects associated with daily life, mostly by the growing importance of profit pursuit. Thus, many activities which were intended...
to be carried out as a hobby have become real “cash factories” and one specific example in this direction is football. The globalization phenomenon has sped up its development as an industry, by reducing the differences between countries and emphasizing the connections between them. In this respect, we acknowledge the existence of multinational football squads, live television broadcasts for international fixtures, swaps between team management styles from different football cultures, direct foreign investments in football clubs, increasing number of international fixtures and the transformation of events such as the World Cup, the European Football Championship or Copa America into real money-making machines, with a major impact on a macroeconomic level.

Moreover, given the large amounts of money and the passion implied by this phenomenon, many assumptions were developed in connection with accounting operations, profit quality and, also, the true and fair disclosure in the financial statements. However, problems have arisen in this respect, fueled by the incomplete harmonization regarding the adoption of accounting standards for football clubs (international regulations versus national regulations). Throughout this paper, we intend to identify accounting issues arisen in the football industry, to study the international and national football governing bodies regarding financial reporting, to study the issue of football players’ contract valuation, in order to express a well-grounded opinion towards the football clubs’ financial stability and the importance of correctly accounting the operations in case of a football club. We will take into consideration the impact of the financial statements on the licensing process from the football governing body (by referring, especially, to the Union of European Football Associations – UEFA).

2. Literature review

During our research, we acknowledged that the topic of human resource accounting has been intensely debated by theorists and practitioners and it remains highly controversial. Through the present paper, we aim to establish on which grounds the disclosure for the football players’ contracts can be improved (given all aspects associated with it, such as recognition, measurement and presentation within the financial statements). However, we also need to establish the topics’ research status in order to have a better reasoning for the ideas that we intend to state within this paper. Thus, we concentrated on two specific sets of papers from the literature, respectively: papers which discuss the general topics of human resource accounting or intellectual capital reporting framework and papers which specifically present football players’ contracts from an accounting point of view.

The first set of papers is important for our research because it sets the assumptions for understanding the human resource’s status within the organization and its ability to significantly influence the company’s performance. In this respect, we studied the works of Gröjer, 1991, and Flamholtz, 1985 (edited and republished in 1999) on human resource accounting (which provide a cornerstone for research developing on the topic). Furthermore, Roslender and Fincham, 2001, 2004, showed the researching interest on the measurement and reporting of intellectual capital (through a critical point of view) and conducted a case study on UK firms. Another interesting case study was earlier conducted by Edvinsson, 1997, which describes Skandia's approach to measuring intellectual capital. Mouritsen et al, 2001, analyze 17 firms’ work to develop intellectual capital statements as managerial technologies making knowledge amenable to intervention and conclude that such forms of intervention circumscribe the aspiration to transform knowledge from something internal to the person into something that is the effect of a collective arrangement. On the same topic, Guthrie et al, 2004, suggest, in their paper two, theoretical foundations for further investigation into the voluntary disclosure of IC by organizations and attempt to explain why content analysis is well matched to both these theories as a means to collect empirical data to test research propositions.
The papers from the second set present various case studies on football human resource accounting. In this respect, Morrow, 1996, discusses whether the prospective services provided by a football player on of the club holding his registration can be recognized as an accounting asset. He focuses on accounting appropriateness according to the FASB and several valuation methods for the contracts (such as the historical cost for transferred players, the earnings multiplier and capitalization at directors’ valuation). A similar paper was written by Rowbottom, 2002, who investigates the use of intangible asset accounting and the selection of accounting policies in the football industry, an environment where discretionary choices were available concerning accounting for transfer fees and states that proxies representing the level of tax costs, equity depletion, underwriter pressure and auditors used are found to have significant associations with policy selection.

Morris et al, 1996, as well as Morrow, 1997, extend the research on the implications of the Bosman ruling for professional football clubs in the UK; they consider various possible accounting treatments and conclude that in the short term at least, given the uncertainties surrounding the industry post Bosman, recording the cost of players’ registrations at their historical cost is the most appropriate policy for clubs to adopt. Amir and Livne, 2005, study the impact of FRS 10 on accounting and valuation of football player contracts and find that transfer fees paid are positively related to market values, but require further research. This paper is later discussed by Forker, 2005. Moreover, Morrow, 2006, compiles a case study, in which he investigates the selection of accounting policies for intangible assets in the Italian football industry, focusing on the effects of the so-called “salva calcio decree”. The decree permitted clubs to amortize the asset of players’ registration rights over an arbitrary time period of ten years rather than over the length of players’ contracts, thus improving clubs’ reported financial position and performance.

On football clubs’ disclosure level, Shareef and Davey, 2005, have studied the quality and extent to which 19 listed professional English football clubs are reporting intellectual capital in their annual reports for the 2002 period. They have developed and applied a disclosure index, giving scores for categories of disclosure and for the football clubs. The research findings suggest that components of intellectual capital were poorly reported by listed professional football clubs. Also, Lozano and Gallego, 2011, study the deficits of accounting in the valuation of rights to exploit the performance of professional players in football clubs (mainly focusing on Spanish Accounting Standards) and develop a case study to provide evidence of the enormous hidden values the assets of these clubs contain.

3. The reporting framework in football industry

3.1. General reporting information for football clubs

In order to be affiliated to a national football federation and, respectively, to be able to compete in international competitions, every football club is required to apply for a license and to meet a series of criteria. There criteria are stated in the UEFA Club Licensing and Financial Fair Play Regulations and they are transposed and integrated within national football regulations. Monitoring the fulfillment of these criteria is carried out on an annual basis and the Licensor is compelled to thoroughly check all aspects in accordance with the mentioned regulations.

Basically, the regulations state that a football club – in order to be licensed to compete – is required to meet 5 specific criteria, respectively: the sporting criteria (youth development, medical care, player registration, seminar attendance and racial equality), the infrastructure criteria (stadium and training facilities), personnel and administrative criteria (requirements for human resources), legal criteria (written contracts, legal group structure and ultimate controlling party) and financial criteria (reporting perimeter, annual and interim financial statements, overdue payables status and future financial information).
In accordance with the financial criteria, football clubs are compelled to apply the international accounting and financial reporting regulations (with referral to the International Financial Reporting Standards). Thus, the clubs must prepare and submit audited annual financial statements to the Licensor, in order for the latter to assess the level of compliance with the regulations regarding financial reporting. In special cases – when the deadline for submission surpasses 6 months, interim financial statements are required as well.

Another aspect that is monitored in the licensing process is the adequate management of payables and receivables. Overdue payables are not permitted in case of football clubs and such situations may have more severe consequences than in the case of regular companies, such as: sporting court action, banning player transfer for an indefinite period of time, point penalties within the national leagues, fines from the financial administration, expensive compulsory compensations, divisional relegation and, in the worst case scenario, license refusal (which means that the club cannot compete in any division).

For a football club, the brand is an essential element because it attracts supporters, investors and sponsors. The implication in certain scandals, court action or penalties (such as relegation) would significantly damage the football club’s image, with serious implications on financial performance. Thus, the sporting management, together with the administrative and financial management, must have a common objective – to create an image for the club that would have a strong impact on the public and that can be able to create loyal supporters, as much as to attract financial investments from those who have the ability and will to comply with the strategy (through direct investment or the stock market).

In other words, we can state the general idea that football is no longer “just a sport”, but it has developed into a well-run business. Large amount of revenues are no longer obtained through game and season tickets and the supporters have become a target for clubs only as cash generators. The financial and commercial sides now have the interests of club managers, in the eternal pursuit of profits.

3.2. Football players’ contract registration: regulations and practice

The most important element for a football club is the football squad of players. Without them, the football club would certainly not participate in competitions, nor will it justify the existence of other assets and carry out its activity (in other words, it wouldn’t justify its entire existence). Thus, the players generate the assumptions of potential economic benefits for the club.

However, it is not permitted for them to be accounted as assets within the books because one does not have property rights on another person; on the other hand, nor can the contract itself be registered as an asset. To have a contract with a football player means that a club may use that player within the entirety of the team (Aronsson S. et al, 2004).

In this respect, the rights to use the player derive from the contract and they can be accounted as an intangible asset. This is possible due to the fact that, at the time of the contract’s registration to the governing body, the club acquires the federative rights and license to use him in competitions. Moreover, the football industry is a special case where the human resources management has impact on the assets of an economic entity. However, the international accounting standards do not accurately state the recognition of human resources in the asset category, but it rather offers the preconditions for accounting them (according to article 21 from IAS 38).

One major problem that arises is that there are three types of football players, respectively: players registered through transfer, players registered as free agents (according to the Bosman ruling) and players promoted to the first squad from the youth academy.

For the football players, the valuation process is a difficult task due to the fact that there are no two players alike (a characteristic of human resources). In the case of players registered through transfer, a credible valuation of the asset cost can be carried out because there is a firm payment (plus the expenditure connected
to the purchase which, according to the regulations, is included to the value of the asset – e.g.: the agent’s fee, percentage from the transaction paid to the initial club etc.) and an active player transfer market, which can be considered a ground for valuation (in accordance with article 25 from IAS 38).

UEFA allows the clubs to issue and apply own accounting policies, as long as these policies are in accordance with national and international accounting regulations. However, given the fact that many countries have adopted the IASB regulations, the appliance of the IAS 38 has become a requirement for the majority of the European football clubs.

The former regulations – before the adoption of IAS 38 – allowed the clubs to choose between the capitalization of the use rights derived from these contracts and the full embedding of the transfer cost in the Income Statement (as operating expenditure or as exceptional expenditure). This type of accounting – through recognition of the transfer cost as an operating expenditure – was considered to be compliance to the prudence principle, but it was – in fact – a distortion of the income statement in terms of image, even though the respective operation did not generate immediate benefits (Rowbottom, 1998).

As an intangible asset, the license to use the player paid through the transfer fee needs to be gradually written off. In this case, the write-off will be carried out throughout the economic lifespan of the asset (meaning the duration of the contract). The period of time associated to the value recovery of the asset cannot surpass 5 years, as the contract cannot be negotiated further (according to the new regulations) (Aronsson et al, 2004). On the other hand, if the value of a player’s contract is considered to lower (given his performance, injuries, conflicts etc.), the club may write down the value. In order to be able to do this, the club must have a comparison value and a solid reason. Adversely, write-ups are not recognized, in accordance with the prudence principle in accounting.

The transfer market in the case of football players has a high level of information asymmetry because the buyer club doesn’t know, most of the times, an exact assessment of the overall index of abilities and flaws for a certain player (except the scouting reports) and cannot be assured of the player’s performances. For example, a club can pay a large amount of money on a player which proves to have a difficult behavior, can damage the club’s image, can deteriorate the team atmosphere and will lead to a lack of sporting an financial performance. On the other hand, a player transferred on a small amount of money can have remarkable performances, creating a synergy effect and leading to accomplishments, such as winning competitions. This type of player can be transferred further, on a considerable amount of money (generating a financial benefit through the positive transaction differential).

A more delicate issue arises in the case of a player contract’s expiry. The regulations before 1990 stated that, in the moment of a player contract’s expiry, the management was required to offer the player a contract with a minimum set and value of clauses as the former contract. If the player declined the contract offer, he could have been transferred to another club, but only with the current club’s approval. If the player no longer served to the interests of the club, he could have been declared a free agent. Such a system was created in order to avoid the loss of the federative use rights for talented players, but it constricted the freedom of movement for labor.

In 1990, the Belgium football player Jean-Marc Bosman sued his football club – RFC Liege, The Belgium Football federation and UEFA at the European Justice Court, on the ground that the former article 17 from the FIFA regulations constricts the freedom of movement for workers (stated within article 48 of the European Union Treaty). After 5 years of trials, the European Justice Court granted a favorable ruling for Bosman and compelled UEFA and FIFA to change the regulations.

Thus, at the contract’s expiry, a player is declared a free agent and can negotiate his own contract with another club. Moreover, the residual value for the contract in accounting books must ultimately be null (in the case of accounting the contract as an intangible asset). The players are allowed to sign an initial agreement
This ruling is not favorable for small clubs as they can easily lose their star players, if they cannot be offered adequate contracts.

As a result, free agents have greater negotiation ability than transferred players because the transfer fee is no longer paid. Thus, they can demand higher wages, bonuses and installment premiums.

Another problem with these players arises in the case of valuation as it cannot be carried out in a credible way (in absence of a transfer fee and an active market). Comparative values with the market are inaccurate due to the fact that their negotiation ability is greater and the fair value determined of market parameters cannot be carried out.

An alternative valuation option would be at the value of the installment premium, which could be written off throughout the contract’s duration and is a guarantee of the license acquirement for the football player. However, this option is largely discussed and is not adequate in all the cases; in this respect, the free agents’ contracts are not recognized as intangible assets due to the fact that there is no credible ground for valuation.

A third type of footballers is represented by youth players. The youth academy is a very important element for a football club as it assures an ongoing scouting process, it helps lowering medium squad age and it carries the continuity of this sport. The academy’s existence is stated in the UEFA licensing regulations and is a very important subject within the task sheet. Thus, the clubs must have a very well established scouting system, separate youth teams for different age categories, educational programs regarding rules of the game and prevention against use of prohibited substances (anti-doping), qualified personnel, healthcare, management strategy and a development strategy approved by the Licensor.

As for accounting the players from the youth academy, they cannot be reflected in the asset category because they do not meet the preconditions from IAS 38. First of all, underage players cannot have professional contracts. As a result, no use rights can derive from such a contract that can be set as a ground for accounting. Second, there is no control over these players (a standard 3-year contract can be offered to a youth player coming of age, but he is not compelled to accept it). Last, but not least, youth players do not generate, through their status, future economic benefits (the activity of the academy is rather resource consuming).

In case they accept a professional contract, the status quo will significantly change as they are registered at the federation and are eligible for accounting as free agents. There are significant differences between experienced free agents and youth players (in terms of wage and installment). The exception is represented by the talented youth players from major clubs, able to offer them the conditions to remain in their squad. Most clubs do not afford the luxury of granting talented youth players’ lucrative contracts due to financial difficulties.

### 3.3. Valuation options for football players’ contracts

As mentioned before, the disclosure of the free agents and the youth players within the financial statements is potentially problematic due to the fact that there is no solid ground for valuation and no active market for comparable parameters (in order to supply a credible value). However, this specific case has comported the appliance of accounting and valuation methods developed by theorists in the literature. More specific, two of these theories have proven to be relevant, respectively Jan-Erik Gröjer and Eric Flamholtz’ theory.

In the first theory, Gröjer states that one option to valuate an intangible asset connected to intellectual capital can be carried out through wage capitalization. In the case of football, the club is compelled to pay all the player’s respective wages throughout the contract’s duration, the latter being required to play adequately to the team strategy and perform as expected. Thus, we could have an estimative value of the player’s contract connected to the initial investment – that could be written-off in equal installments (through payment of
wages). This type of valuation is considered adequate for free agents (players under Bosman ruling), where the negotiated wage would be considered appropriate as valuation ground.

However, this theory has its flaws, which would limit its appliance in the case of football clubs. First of all, there is the issue of controlling the player – which is an essential precondition for accounting an asset. Even though wages are capitalized and the club accepts the payment liability (Aronsson et al., 2004), the actual control over the human resource is highly relative. Thus, there is no certainty that the player will perform as expected. After all, he can be fined and held accountable, but he cannot be forced to play (the contract can be terminated in the terms stated by the FIFA Regulations on the Status and Transfer of Players). Moreover, free agents’ wages are greater than transfer-based players; the recognition of the value difference would lead to an artificial overvaluation of the assets (without a certainty of cash-in).

On the other hand, Flamholtz’s theory states that recruitment costs can be associated to an employee’s contract. In this specific case, the recruitment costs can be easily identified for the academy, in the information set requested by the Licensor (training costs, personnel, facility costs etc.). The problem for this theory is that these costs are determined globally, for the entire academy and the distribution per player – for valuation purposes – is carried out only for the players who choose to sign a professional contract (Aronsson et al., 2004).

This theory is more adequate for player valuation than Gröjer’s because – within the determined value – there are comprised the costs with development, as well as the performance enhancement. Moreover, disclosure requirements established by UEFA and FIFA (especially, within the explanatory notes) set the framework for other clubs to use information for the valuation process. The sole problem remains the development of an adequate internal cost management system for each academy, which can offer an exact value of the contract at an individual level.

4. Concluding remarks

Nowadays, football is no longer just a hobby, but it has developed into a real profitable industry. Clubs in the upper divisions, which compete in the international fixtures, are the ones that attract a great number of investors and sponsors and are the most profitable. The reason for the investment decision should be grounded on accounting data disclosed, remaining to be settled if these data are credible and relevant for the stakeholder. A complete, true and fair view on the club’s financial position is hard to be obtained if there are no firm regulations from the governing bodies, but only recommendations for the accounting methods.

Regarding the valuation methods, we consider that applying Flamholtz’s theory is more relevant because using past firm investments within the process of a player’s valuation (recruitment cost) is more relevant than an estimation on value based on future wage payments (keeping in mind that the player’s performance is uncertain). Flamholtz’s theory is more adequate as it sets a credible ground value for the players, used to construct credible transfer fees, according to the dynamics of the players’ parameters and performances. On the other hand, Gröjer’s theory tries to set the investment return in a player, embedding a risk which appears at the contract’s signing date, without offering an actual value of the player in accounting books (as it is essential only for assessing the negotiation ability for the contract rights and it can lead either to undervaluation or to overvaluation).

Ultimately, we can acknowledge that players and supporters have lost their place on the main stage to the marginal interests of investors. Moreover, we can state that the former have become “mere pawns on the chess table” that is the football industry worldwide. It remains to be seen how much will this industry develop in the following years, how well will the governing bodies manage and improve the rules of the game and how will the accounting regulations modify – in order to have a better framework for human resource disclosure. The case for football presented in the current paper can set the ground for a future research, which can extrapolate the paradigm to an extensive level of disclosure for intellectual capital reporting.
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References


