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**CHAPTER ONE**  
**INTRODUCTION**

**1.1 BACKGROUND OF THE STUDY:**

There is a popular maxim that human resources are the greatest assets at the disposal of organizations.

In mission statements, annual reports and annual general meetings, organizations declare that “our greatest assets are our people”. Mayo (2006) posits that people are often spoken of as assets, but are generally treated as cost because there is no credible system of valuing them.

Fajana (2002) asserts that current accounting procedures deal with human resources as expense rather than as investment. This is perhaps the essence of human resource accounting otherwise referred to as human capital accounting or human asset accounting. According to Fajana (2002) under conventional accounting system, utilization of money and materials are reported whereas, the value of human resources is seldom incorporated in financial statements. Human capital accounting relates to the quantification in monetary terms (e.g. by calculating a capital value) of human resources employed by an organisation.

A well-developed system of human resource accounting could contribute significantly to internal decisions by management and external decisions by investors (Fajana, 2002). Rao (2005) opines that human capital accounting helps potential investors judge a company better on the strength of human assets utilized. Thus, if two companies offer the same rate of return on capital employed, information on human resources can help investors decide which company to choose for investment. Until recently, the value of an enterprise as measured by the traditional balance sheet was viewed as sufficient reflection of the enterprise’s assets. However, with the emergence of the knowledge-based economy the traditional valuation has been called to question, due to the recognition that human capital is an increasingly important part of an enterprise total value (Bhargava, 1991). Perhaps it was the realization of the shortcomings of the traditional balance sheet as a basis of business performance evaluation that led Kaplan and Norton (1992) to develop a framework that incorporates all qualitative and abstract measures of true importance of a firm, called the balanced scorecard. By focusing not only on financial outcomes but also on the human issues, the balanced scorecard helps provide a more comprehensive view of a business. This in turn helps organization to act in their best long-term interest. The financial objectives are therefore balanced with customer, process and employee perspectives.

Marshall (1961) had also said that the most valuable of capital is that invested in human beings.

However, unlike capital invested in other assets, the balance sheet does not exhibit this most vital asset.

For a long time, Accountants have not given due consideration to the “employee value” in the enterprise. The heavy amounts incurred on recruitment, selection, placement, training and

development of personnel were generally treated as revenue expenditures and debited to Profit and Loss Account of the period they were incurred. Proper appreciation of human capital accounting will help management take suitable decisions regarding investment in human resources. It will also provide comparative information regarding costs and benefits associated with investments in human assets. External users of accounting information, particularly investors will find the study very useful as it will reveal how critical the quality of human assets is to the earning potential of a firm. The study may also help human resource managers to develop management principles by classifying the financial consequences of various human resource practices and monitoring effectively the use of human resources. In Nigeria for instance, in 2006 Unilever invested over N40 million in training its employees, besides in-house programmes to develop staff, and mutual expatriation of employees in sister companies abroad (Annual Report 2008). As far back as 1988, Nigerian Breweries Plc invested more than N88 million in local and overseas training of staff. Access Bank Plc in 2007 commenced construction of an Access Bank Campus otherwise called Access University of Banking Excellence.

Wema Bank Plc has a policy of sending each staff to relevant training for at least 80 hours in each financial year. These heavy investments to train and retain quality staff are not reflected in the balance sheet of these various organisations. Indeed, they are charged against revenue for the period to reduce income and by extension the value of the business, when "everything is viewed in terms of the bottom line". In the light of the above, many are wondering whether capital markets' obsession with profitability as almost the sole indicator of corporate performance does not encourage management to take actions which focus on the short term at the expense of the long term.

## 1.2 STATEMENT OF PROBLEM

One shortcoming of human capital accounting is the measurement of the contribution of education to human capital as net investment that includes the effects of the aging of the enrolled rather than gross investment that excludes the effects of aging. The account does not present measures of gross investment because of its sensitivity to assumptions about how persons who did enroll in school would have behaved in future years had they not enrolled in school. Gross investment in education in a given year is equal to the effect of school enrollment on the stock of human capital, the difference between actual human capital and what the stock of human capital would have been had no one enrolled in school that year. The latter depends substantially on what assumptions are made about the school enrollment decisions that people who actually did enroll in school would have made in future years had they not enrolled in school.

To illustrate this sensitivity, consider two different scenarios. The first scenario is similar to that of traditional human capital accounts. In this scenario, it is assumed that people who enrolled in school in real life would, in the counterfactual case of no enrollment for 1 year, become like people who did not enroll in school in real life. This has dramatic implications. Most persons who are enrolled in school are making normal progress in school enrollment with age and are "on track" to earn their high school diplomas at around age 18 or their bachelor's degrees at around

People who are behind normal progress by a year or two are in a sense "off track," which has serious implications for eventual educational attainment. For example, in 1994, the probability that an "on track" 17-year-old male with an 11th grade education enrolls in 12th grade and finishes high school is 94 percent. If he misses a year of education and falls "off track" by 1 year, that probability drops to 79 percent; fall another year "off track," and it drops further to 30 percent. If we assume that persons who are "on track" would behave like persons who fall "off track" if they missed a year of education, the cost of missing a year of education is very large. Consequently, gross investment in education is extremely high.

In contrast, consider an alternative scenario. In this scenario, we assume that people who attended school in real life would not fall "off track" in the counterfactual of no enrollment for 1 year. Their likelihood of further enrollment would not drop; instead, they would enroll in

further schooling at a rate equal to the enrollment rate of persons of the same education level who are 1 year younger. So, for example, consider again the 17-year-old male with an 11th grade education, whose probability of enrollment in 12th grade is 94 percent. If he did enroll in school, then we assume that had he not enrolled in school, his likelihood of enrollment in 12th grade as an 18 year old would still be 94 percent—and not 79 percent, which is the enrollment rate in 12th grade of actual 18 year olds with 11th grade educations. Consequently, the student stays “on track” toward finishing his diploma or degree when he misses a year of education; we assume in the counterfactual that his likelihood of enrollment in 12th grade is not affected by having missed a year. In this scenario, the cost of missing a year of education is much smaller, and as a result, gross investment in education is much smaller.

Under the assumption that persons who did enroll in school would have fallen “off track” had they not enrolled, the market component of gross investment in education in 2005 equals \$16 trillion, greater than the entire gross domestic product (GDP) of the United States. In contrast, under the assumption that persons who did enroll in school would have stayed “on track” with a year’s delay, the market component of gross investment in education in 2005 equals \$3.1 trillion. Under this assumption, the market component of gross investment in education is still nearly four times greater than the measured output of education in traditional GDP accounts, which was \$807 billion in 2005.<sup>7</sup> Substituting this measure of gross investment in education into GDP as a measure of the output of the education sector would increase total GDP by 18 percent (from \$12.4 trillion to \$14.7 trillion) and the share of education output in GDP from 6 percent to 21 percent—quite an impact for what is probably a conservative measure of human capital investment from education. There has been a lot of problems since the adoption of human capital accounting in Nigeria which includes the following:

- Ø The extent of development of Human Resource Accounting in Nigeria.
- Ø The extent to which Human Resource factors influence investment in Nigeria.
- Ø The desirability of incorporating value of Human Assets in financial reporting in Nigeria.
- Ø The relevance of Human Capital Accounting to investors in the Nigerian accounting system.

### 1.3 OBJECTIVE OF THE STUDY

This research work focuses on providing the missing link through human capital accounting in corporate or financial reporting, This study aims at:

- Assessing the extent of development of Human capital accounting in Nigeria.
- Determining the extent to which Human capital factors influence investment in Nigeria.
- Evaluating the desirability of incorporating value of Human Assets in financial reporting in Nigeria.
- Ascertaining the relevance of Human Capital Accounting to investors in the Nigerian.

### 1.4 RESEARCH QUESTION

Ikeagwu (1998:77-78) sees Research question as the platform through which the researcher looks for facts in the fi

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