

# **HUMAN CAPITAL, BELOW THE LIMITS OF NATIONAL ACCOUNTING STANDARDS**

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## **Abstract**

Human capital, as a part of intellectual capital, is restricted by the situation provided by current accounting and national and international financial reporting standards. The human factor is the one that mirrors the result and performance of the company. It is the one that guides the fulfilment of the objectives. The fear of human capital detailed reporting is attested in the current situation of Romanian society reporting. The research objective is to identify the limitations imposed by national standards in evaluating human capital. Using the analytical research - theoretical knowledge method, the research is based on the analysis of Romanian laws and standards, which aims human capital. It is known that employees are an indispensable element in any company, and its presentation cannot be limited by elements of financial analysis. Through the analysis of national standards, it could be identified that the evaluation of human capital is descriptive and is limited to factors such as time, budget, descriptive and subjective methods. It is important to know the legislation that attests the human factor evaluation and presentation, to know its situation in terms of Romanian reporting.

## **Keywords**

Human capital, National Accounting Standards, Human Capital National Reporting, Limits of National Accounting Standards.

## **JEL Classification**

A10, K20, M10

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## **Introduction**

The national accounting standard is Accounting Law no. 82/1991 with subsequent amendments and completions. The national financial reporting standard is the Minister of Public Finance Order no. 1802/2014 (OMFP no. 1802 since 2014). This standard is the guide for preparing financial statements in Romania, by companies that are not part of an international group. The companies that are part of an international group prepare financial statements according to the financial reporting standards related to the country

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in which the parent company has its headquarters. In the current financial reporting must be known the importance of human capital evaluating and its presentation in accounting at the level it deserves. Highlighting the most important situations presented to external and internal users determines a clear and complete picture of the situation in which the company is at the time of analysis. Another opportunity determined by the presentation and analysis of national legislation on human capital reporting is the knowledge of elements that can be changed and implemented.

The reluctance with which the inclusion of human capital in the sphere of assets is viewed and its presentation as such in the sphere of accounting is determined, according to the perception of many Romanian economists, by the lack of control over it. The economic benefits it brings are highlighted in any company. If the measurement, evaluation and control of human capital are, at the moment, aspects for which it is not included in the assets sphere, its reporting is a must-have for national and international reporting.

The voluntary human capital information presentation does not attest to a comparability possibility of financial reporting. An external user must understand what happens within a company where he wants to invest in and have to know and understand the staff who, in a long time, can ensure the performance, profitability and business smooth running. As an employee, everyone knows the dedication with which he completes an activity within the company in which he works. As an employer, it is necessary to know for every employee the value and contribution. Its presentation in the financial statements represents the exposure of the employee's value in the external environment and at the same time his motivation. Also, it can be presented in financial statements in relation with structural and relational capital. In this way, intellectual capital can be visible. Financial statements are the only documents that can tell the whole companies story. The omission of his presentation attests to an incomplete image. The current situation of human capital accounting is provided as a lease of knowledge and skills by the company. The salary debt is not practically counterbalanced by the actual benefit brought. At the same time, another identified problem is the limitation of the employees' performance by the Romanian legislation.

For human capital to be reported in the financial statements of all companies, the value that each employee has within the company must be known. For an employee's value to be determined, it is necessary to know how it can be assessed. By knowing the evaluation methods imposed by national laws, it is possible to know if these methods are complete and if they give a real image to the employee. Thereby, for this assessment to be carried out, the modalities imposed by national laws must be determined. The objective of the research is to determine the limitations of national laws in evaluating the employees. By applying these laws, a subjective, descriptive evaluation emerges, without a high degree of complexity and completeness.

The research is divided into four sections: a review of the scientific literature- human capital perception and accounting standards; research methodology- including the main questions on which the research is based and the methodological part utilized; results and discussion-findings of the limitations for employees' evaluation; conclusions.

### **1. Review of the scientific literature**

In today's economy where nothing can be predictable, companies place internal learning as the main goal, by creating intellectual capital and competitive advantage (Lennon and Wollin, 2001). Intangible assets consist of the external structure (customer relations, suppliers and brands), the internal structure (managerial organization, legal structure, IT systems) and individual skills (education and experience) (J. Mouritsen, H.T. Lasen, P.N. Bukh, 2001). The structure of intellectual capital is given by human, organizational and structural capital (J. Mouritsen, H.T. Lasen, P.N. Bukh, 2001). People are seen as the sole agents of companies, and all tangible and intangible assets are the result of human actions and depend entirely on people for the continuity of their activities (Karl-Erik Sveiby, 2001).

As small companies gradually develop with their human capital, the stages of evolution should outline a separation of the roles of intellectual capital in different stages of the company's life cycle (Muda and Rahman, 2016).

Named within Skandia the "need for new accounting" (Edvinsson, 1997), intellectual capital is an accounting element not yet reported. Intellectual capital is additional information to the company's financial information, a non-financial capital, an element debt, not an asset (Edvinsson, 1997). To be highly competitive and successful, firms must create and sustain a portfolio of intellectual capital (Wiig, 1997).

While most firms reported employees to benefit in detail, more than one-half of the firms reported the educational background of employees, employees' compensation plans, employees' involvement in the community and the list of training programs provided and extent of employee participation (Khan and Khan, 2010).

This minimal information is marked by a lack of stern encouragement on the part of regulatory bodies or minimal pressure from stakeholder groups (Khan and Khan, 2010). Human capital disclosure may be a way to reduce the level of information asymmetry between managers and shareholders (Fontana and Macagnan, 2013).

Regarding the reporting of human capital by Romanian companies, the national stage is characterized by a low degree of dissemination of the information on intangible assets (Fadur et al., 2011). At the same time, the integration of intellectual capital in economic and financial reports is necessary because since intangible assets are essential for business success (Gogan and Draghici, 2013). The situation of intellectual capital reporting in Romania is also reduced to the perception of stakeholders in the sense they have to understand the advantages of having and properly managing the intellectual capital and its impact on the creation of organizational value (Morariu, 2014).

The situation of reporting intangible assets in Romanian companies may be based on the following question: "Is there a lack of interest for Intellectual Capital's components within Romanian listed companies, or more likely a lack for a disclosure and evaluation framework for the Intellectual Capital which does this information be considered irrelevant for the company?" (Ienciu and Matiş, 2013).

Through the objective evaluation of the employee, an optimization of the tasks can be achieved. The optimization of tasks in a company determines two trajectories, namely the approach to tasks and innovation (Fonseca et al., 2019).

As a factor that influences the actions of human capital, it is the organizational culture through the quality of the workplace, the benefits received the company reputation,

diversity and pluralism of the workplace (Chatterji and Kiran, 2017). Also, due to the lack of the real value of employees, its reporting is narrative (Duff, 2018).

## **2. Research methodology**

Starting from the following research questions: How important is the presentation of human capital (employees) in the financial statements, for its knowledge by external users?, How often the Romanian economists encountered additional requirements regarding the preparation of financial statements - Auditors, English translations, parent company requirements?, How bidder is the legislation in Romania regarding human capital?, this research aims to show the current position of human capital in the field of Romanian legislation.

To address the research questions, the main method adopted was the theoretical approach. This method was used to identify the legislative barriers regarding reporting and evaluation of human capital in Romania.

The scope of applying this method was to determine the limitations of the assessment of human capital in accordance with national laws.

Knowing these limitations is important in the sense that they underlie the lack of knowledge the employees and their reporting to the level at which they deserve to be known by the external environment. The following laws were used as theoretical research: Order of the Ministry of Public Finance no. 1802/2014 (OMFP no. 1802 since 2014) - in presenting human capital in financial reports; Law on salaries for staff paid from public funds no. 153 since 2017- for identification the limits regarding the salary and evaluation of the employees within the public institutions; Order no. 974 since June 2, 2020 on the establishment of criteria for the evaluation of individual professional performance- for identifying staff evaluation limits; and Accounting Law no. 82 since 1991.

An additional purpose was to complete the theoretical method with the empirical research. This method was used to support the need for national legislative change. The questions were analyzed statistically to increase accuracy. Descriptive Statistics was used to validate the answers received. The questions measured the importance of presenting human capital in financial statements and the frequency of requests for preparing financial statements. Using the quantitative method, the perception of 104 Romanian economists regarding the importance of their reporting in the financial report was determined. A questionnaire was applied, using Google Forms Platform, from July 27 to August 2, 2020. The questions analysed in this research are extracted from a questionnaire consisting of 18 questions, used in previously research (Diana-Nicoleta Nita, 2020). Out of the total questions, only 2 were used as they pursue the objective of the present research. The questions used for this research are: “How important do you consider the presentation of human capital (employees) in the financial statements, for its knowledge by external users? (Presentation of all information such as evolution, investments and results obtained. Not only employees’ indicators)” and “How often have you encountered additional requirements regarding preparing financial statements- Auditors, English translations, parent company requirements?”. The questions are following a 5-point Likert scale: 1-strongly disagree, 2-means disagree; 3-neutral option; 4-agree; 5-strongly agree.

It was covered a sample of respondents with ages between 18-41 years: 13% of them are between 18-24 years, 37% of respondents are between 25-40 years and 50% of them have more than 41 years old. According to their positions in the companies where they work, 66% of the respondents occupied operational positions and 34% of the respondents occupied managerial positions. According to their experience in the economic field, 4% of them have less than 1-year experience, 27% between 1-5 years' experience, 11% of them between 5-10 years' experience and 58% more than 10 years' experience. The respondents work in the financial departments of public and private institutions from Romania. The respondents from the public environment are working at the National Administration of Public Finances, Romanian South-Muntenia region. Answers were obtained from people who are certified by the Romanian Body of Expert Accountants & Certified Accountants, and a large number of respondents have Management of Business Administration and Association of Chartered Certified Accountants qualifications. Therefore, were obtained the perceptions of the key people from the economic environment.

### **3. Results and discussion**

According to OMFP no. 1802 since 2014 with subsequent amendments and completions, Chapter 6, staff costs should amount to "salary entitlements, bonuses, allowances, salary fund awards, rest leave allowances, as well as those for temporary incapacity for work, paid from the salary fund, the premiums representing the employees' participation to the profit, granted according to the law, and other rights in the money". Therefore, there is only an image of what the company consumes with its employees, not the benefits they bring. By the possibility of accounting the employee's participation in the profit, the premiums granted to the employees for the benefits brought are highlighted. In practice, however, the accounting of such bonuses aimed at the participation of employees to the company's profit is not common. It is demonstrated that in accounting, the employee's contribution to the company's profit does not represent an obligation for companies to be allocated. But, unlike the private environment, the public environment offers to employees a pay system respecting the wages principles. A part of salary principles is the principle of transparency of the mechanism for establishing wage rights and the principle of equality according to which "equal basic wages for work with equal value." Therefore, in the public environment, there is no opportunity of highlighting the staff's participation in the result. The public institutions' employees are considered equal, occupying positions according to public criteria such as: work experience, education. Regardless of the employees' quality or the added value brought during a year, they represent, as in the private environment, only a constant consumption.

Another interesting element is specified in Law no. 153 since 2017 about the employees' remuneration paid from budget funds. It is attested that if the evaluations show achievement of exceptional activity, an increase in the amount of 50% calculated at the basic salary can be granted, but only for a maximum of 5% of the total number of employees (Law no. 153, 2017). Therefore, it turns out that, for example, out of a total of 100 employees, only 5 of them can benefit from this salary increase, even if, during a

year, there is a chance that out of the total number of employees, 10 of them will be performed exceptional activities. It is observed the limitation of discovering the valuable employee. A percentage cannot be imposed for exceptional staff.

It should be specified that the evaluations of the budgetary employees are carried out by granting qualifications, depending on the fulfilment of some objectives. Also, the evaluation can often be subjective. This assessment is taken into account when it is possible to advance.

The current accounting attests that the value of an employee is summarized at the salary value it has. Considered a direct expense in the production process, human capital is the indispensable element for a production process. A factor of production, human capital is considered only an expense, even if after the completion of the finished product, it continues to add value to it.

OMFP no.1802 since 2014, through the financial statements notes, identifies the possibility of presenting human capital. The financial statements notes show that financial reporting can "provide additional information that is not presented in the balance sheet, profit and loss account and, where applicable, in the event of changes in equity and / or cash flow, but is relevant to the understanding of any of them" (OMFP no. 1802, 2014). Human capital may be presented, voluntarily, if the company deems it necessary to present such information and if it considers it relevant to the understanding any element of assets or liabilities. In this sense, the results of respondent's perception about the need for employees' detailed reporting is presented in Table no 1.

*How important do you consider the presentation of human capital (employees) in the financial statements, for its knowledge by external users? (Presentation of all information such as evolution, investments and results obtained. Not only employees' indicators).*

**Table no. 1. The importance of human capital reporting**

|                             | Effective Number | Percentage of total |
|-----------------------------|------------------|---------------------|
| <b>Not at all important</b> | 0                | 0%                  |
| <b>Little important</b>     | 4                | 4%                  |
| <b>Neutral</b>              | 7                | 7%                  |
| <b>Important</b>            | 46               | 44%                 |
| <b>Very important</b>       | 47               | 45%                 |

Source: own research (Diana-Nicoleta Nita, 2020)

The answers received were statistically analysed, and the results are presented in Table no. 2:

**Table no. 2. Statistics of the importance of human capital reporting**

|                           | Values of descriptive statistics |
|---------------------------|----------------------------------|
| <b>Mean</b>               | 4.307692308                      |
| <b>Standard Error</b>     | 0.07493702                       |
| <b>Standard Deviation</b> | 0.764210654                      |

Source: own research using descriptive statistics

The results show the respondents' opinion on the importance of reporting in detail the information on the employees of the companies. The importance of human capital reporting also results from the value of descriptive statistics that is above the average of the answers, namely 4.31, in the sense that the respondents consider it necessary to report human capital in the financial reports (Table 2).

Intellectual capital, as the name suggests, can be considered the intellect of a company. It is the one that includes both the internal competence and the motivating factor (the client). It is the one around which the whole activity is undertaken. There can be no company without a client, IT and organizational structure and knowledge, skills, abilities. But what is most important is the relationship that is established between them. A harmonious connection between the components of intellectual capital determines a successful company.

Identifying the limitations to which the accounting and presentation of human capital are exposed in the Romanian economic environment, shows that human capital's real value is reduced to the value of salary expenses.

The employees' activity is evaluated annually, according to Romanian Payroll Law, by the head of the public institution, at the proposal of the hierarchical superior, by giving the grades "very good", "good", "satisfactory" or "unsatisfactory", unless otherwise provided in the statutes or special laws" (Law no. 153, 2017). Therefore, according to the Romanian wage law, the employee value evaluation is substituted for the descriptive evaluation. The evolution over a while of an employee is under the sign of a grade that does not attest to the value brought to the activities performed. At the same time, Article 8 of the Remuneration Law specifies that the authorizing officers may approve the promotion of an employee only if this promotion falls within the personnel expenses approved by the budget (Law no. 153, 2017). Thereby, the promotion of employees is under the sign of the limit of salary expenses approved in the annual budget. Another limit of human capital according to the national accounting standards is that the promotion in higher professional degrees or steps is done every 3 years, depending on the individual professional performances, appreciated with the qualification "very good", at least twice in last 3 years of activity (Law no. 153, 2017). Therefore, another limitation of the employee in the Romanian public system is identified through the evaluation and promotion time. In this sense, an employee from the public environment must wait 3 years to be promoted based on his performance. At the same time, in the Salary Law, art. 1 specifies that "Authorizing officers may award monthly awards of excellence to staff who have directly participated in obtaining outstanding results in the

work of public institutions or authorities, up to 5% of basic salary expenditures” (Law no. 153, 2017). The value amount of staff performance depends on the budget expenditure which is limited to a percentage provided in the salary law. The added value brought by an employee is limited to a percentage of 5% of the salary expense, even if the benefit brought is incomparable with the consumption.

According to Order no.974 since June 2, 2020, “Assessment of individual professional performance of staff is the objective assessment of individual professional performance, by comparing the degree and manner of meeting the criteria for assessing individual professional performance established with the results actually obtained during a year calendar” (Order no. 974, 2020).

Regarding the recognition of salary expenses, OMFP no. 1802 since 2014 specifies that they are recognized in the income statement when a decrease in future economic benefits related to a decrease in the value of an asset or an increase can be measured reliably of the value of a debt” (OMFP no. 1802, 2014). In this case, it is attested that the employee represents only an expense of the company, without quantifying the increase of the future economic benefits.

Regarding the presence in the financial statements of employees, according to OMFP no. 1802 since 2014, the following must be presented: “contributions for state social insurance due by employers, employees and other assimilated persons, Average number of employees, Actual number of employees at the end period, the equivalent value of the Tickets granted to the employees, the State Contributions allocated to the employees” (OMFP no. 1802, 2014).

In the case of Romanian companies, in the form of branches, which have the parent company in another country, the presentation of employees is established by the group. In this sense, the group is establishing the content of the annual financial statements (Law no. 82, 1991). In this sense, the comparability of the information is ensured only at group level, and at the level of the country where the parent company has its headquarters. In this regard, a questionnaire was conducted on the frequency of additional requirements for the preparation of financial statements. The results are shown in Table 3.

*How often have you encountered additional requirements regarding preparing financial statements -Auditors, English translations, parent company requirements?*

**Table no. 3. Reporting alignment**

|  | Effective Number | Percentage of total |
|--|------------------|---------------------|
| <b>Never</b>   | 13               | 13%                 |
| <b>Few Times</b>   | 23               | 22%                 |
| <b>It is not the case, I did not prepare financial statements so far</b> | 20               | 19%                 |
| <b>Often</b>   | 27               | 26%                 |
| <b>Frequent</b>  | 21               | 20%                 |

Source: own research (Diana-Nicoleta Nita, 2020)

The answers received were statistically analysed, and the results are presented in Table no. 4:

**Table no.4. Statistics of reporting alignment**

|                           | Values of descriptive statistics |
|---------------------------|----------------------------------|
| <b>Mean</b>               | 3.192307692                      |
| <b>Standard Error</b>     | 0.130401891                      |
| <b>Standard Deviation</b> | 1.329843578                      |

Source: own research using descriptive statistics

The results show the frequency of additional requirements that respondents received in order to prepare financial statements. Also, the results demonstrate that the impossibility of financial statements comparability starts from the national level. The answers are slightly above average (the average being 3) (Table 4). Thereby, the participants consider the legislative alignment important, but not in a defining way.

### Conclusions

Human capital is one of the most important elements of a company. Its measurement, evaluation and presentation is a situation that is treated voluntarily by companies. These elements are under the sign of the legislation that, normally, should support the performances of the employees and their presentation in the financial reports. From the evaluation to their presentation, the limitations that occur on employees have been identified. Human capital is under the sign of limitations imposed by national legislation, and its development is limited. Based on the most important national laws in accounting, human capital is restricted by the situation provided by current accounting and national financial reporting standards. The limitations to which the employee is subject are time, budget, descriptive and subjective evaluation. At the same time, their evaluation is descriptive, with a subjective impact, which does not determine an employee's real value.

The evaluation of human capital is the first step in its dislocation in the financial reports. Detailed, valuable knowledge of employee progress is the company's advantage. However, the result of the research is that in the Romanian public environment, the growth and development of the employee in the Romanian public institutions are limited by the barriers imposed by the national legislation. The application of national standards in the evaluation of human capital seems to break the wings of employee development.

One of the research limitations is the lack of procedures analysis at the level of private companies in Romania, in order to know the limitations of evaluating employees in the private sector in Romania. Thereby, the research focuses on the evaluation of public employees in Romania. Another limitation of the research is that it is necessary to know and measure the employees' perception regarding the evaluation methods to which they have been evaluated, and if the laws have been applied exactly, or the public institutions adopted their own procedures.

Thereby, one of the future directions is to identify the perception of employees in the public environment regarding how they are evaluated and to identify the procedures applied in the evaluation of employees.

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