Asian Social Science
www.ccsenet.org/journal.html
Vol. 4, No. 8
August 2008

External Reporting of Human Capital in Malaysia

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Abstract

Human capital information which is vital for effective management of resources is usually only accessible internally within an organization. However, information regarding human capital or human resource investments and the return on these investments are currently not presented in the annual reports systematically and consistently. This paper examines the extent of the disclosure of human capital in the annual reports of Malaysian top companies based on the concept of Human Resource Costing and Accounting (HRCA) and other relevant human capital elements or measures. A content analysis using word count was conducted to determine the extent of human capital disclosures. The findings reveal that the concept of HRCA is still distant to human resource managers in Malaysia. The human capital items which are most commonly disclosed are information on training, human resource development, employee skill, knowledge and competence. Return on human resource investment is not reported in the annual reports.

Keywords: Malaysia, Human capital, Human resource Investment, External reporting

1. Introduction

People are not just being recognized as a vital resource to corporations, but they are also a key source of competitive edge in the current business environment. Many companies view their employees or human capital or human resource (HR) as their most valuable assets and invest heavily on them. For instance, United Engineering (M) Berhad reported in its annual report that "the group takes every effort to identify, develop and retain our human capital and create a more conducive environment for the intellectual assets to grow by putting in the right infrastructure and to ensure the right framework is in place. The group believed that an organzation's success in business is based on the effectiveness of its people and that strategic investments in human capital will add value to any organization in the long run" (United Engineering (M) Berhad, Annual Report, 2004: 36).

However, human capital information is usually only accessible internally within an organization. Such information is currently not presented in the annual reports systematically and consistently. According to Low et al. (1999), the time has come for a radically new way to gauge corporate performance. A reliable way to measure intangibles is vital and there is a need to establish a common framework for describing and representing intangibles, such as defining what constitutes 'human capital'. According to a report by CMA Management (2000), for the first time, a recent study evidenced that there is a cause and effect relationship between human capital management and financial performance. Watson Wyatt's (2001) study on Human Capital Index shows that superior human resource practices are not only correlated with improved financial returns, they are, in fact, a leading indicator of increased shareholder value. Substantial benefits might be gained from better information about HR (Sackman et al., 1989). According to Guthrie (2001), this information might allow resources to be allocated more effectively within organizations and may further

enable gaps in skills and abilities to be more easily identified. It might also facilitate the provision of more comprehensive information to investors or potential investors (Flamholtz and Main, 1999).

Presently, there is no accounting standard on disclosure of human capital-related information. Some companies do not provide any information on human capital in their annual reports since they are not required to do so. Moreover, the current accounting system which was originated by Luca Pacioli was not designed to present human capital as an asset in the balance sheet. However, according to Tan (2000), the future financial reporting in Malaysia is likely to be strongly influenced by the Securities Commission's guidelines which contain a policy statement which states that public companies have an obligation to fully disclose to the public the information necessary to make an informed investment decisions. Hence, we expect to find disclosure or reporting of human capital in the annual reports of Malaysian companies. In the 1960s and 1970s researchers attempt to measure the value of people and to account for investment in HR in the annual accounts. Hermansson (1964) published his pioneering work concerning the valuation of human assets. The term "human resource accounting" (HRA) was used for the first time in 1968 (Brummet et al., 1968). HRA is the process of identifying and measuring data about human resources and communicating this information to interested parties (AAA, 1973). HRA did not achieve widespread acceptance. At the end of 1970s the interest in HRA declined. There are many conceptual problems and practical difficulties to be overcome in HRA. According to Roslender and Dyson (1992), HRA has failed to develop further in the way of practical applications. On the other hand, one reason why HRA has not gained acceptance could be due to the lack of consensus on how human assets should be measured or valued. According to Flamholtz (1985), an erroneous belief suggesting that HRA was concerned only with treating people as financial objects, although preparing financial statements that included human resources was undoubtedly a part of HRA, it was dramatic and innovative, putting people on the balance sheet became the dominant image of HRA for many people. Though there are arguments in favour of treating people as assets, the debate on the appropriateness of valuing HR on the balance sheet remains unresolved. HRA later incorporated the utility analysis aspect and renamed as Human Resource Costing and Accounting (HRCA). In 1990s, some Swedish organizations prepared their own human resource income statements. Lundberg and Wiklund (1994) had found that 70 per cent of the responding personnel managers in Swedish companies with more than 200 employees claimed that they were applying HRCA to some extent. Grojer and Johanson (1998) concluded that HRCA, based on a management control perspective seems to be used to a substantial degree by many Swedish organizations. However, there is not much progress on HRCA in the other parts of the world.

Investment in HR is traditionally and currently being treated as an expense in the income statement. According to Drake (1999), human capital information such as expenditures in the training department appears in the profit and loss account only in the partial and seriously misleading form. In contrary, in the US, as far back as 1967, Barry Corporation has attempted to disclose investment in HR as an asset in the balance sheet. However, it was discontinued due to high implementation costs of human resource accounting system. Critics also considered treating human capital as human assets as a 'sham' to avoid taxes such as the case of a football team, the Atlanta Falcons, which was allocated to non-depreciable intangibles (Weiss,1975).

Today, human capital is incorporated as a part of intellectual capital. Edvinsson (1997) defines intellectual capital as 'the possession of knowledge, applied experience, organizational technology, customer relationships and professional skills'. One component of intellectual capital is human capital. According to Bontis et al. (2001), quite simply, human capital represents the individual knowledge stock of an organization as represented by its employees. Roos et al. (1998) argue that employees generate intellectual capital through their competence, their attitude and their intellectual agility. Along the same line of thought, Hudson (1993) defines human capital as a combination of: genetic inheritance, education, experience and attitudes about life and business. As a result of managing intellectual capital, some companies particularly in Scandinavia, have published intellectual capital statements as a mechanism to show the value of their intellectual capital. Companies have started disclosing intellectual capital, the intangible assets of skill and knowledge in their financial reports (Stewart, 1994). The external reporting of intellectual capital has already begun in Sweden where, in 1996, 43 companies provided intellectual information in their financial statements or in supplementary allied reports. In the context of human capital, Skandia AFS, reported its employees and its network of insurance brokers in a separate report supplementing its annual reports. In 1993, Dow Chemical Company identified intellectual capital as ideas and innovations stuffed into the file drawers and folders of its scientists and engineers. In addition, Sveiby (1997) has developed 'the invisible balance sheet' to account for knowledge-based assets. According to Harrison and Sullivan (2000), by 1994, there were a dozen companies around the world engaged in the active extraction of profits from their intellectual capital. However, no IC statements have been published by companies in Asia except for India (Pablos, 2003). In the past, Malaysian companies did disclose some form of HR information such as key personnel in the annual reports (Tan et al., 1990). As HR management is an important strategy to companies hence it is expected that companies should disclose HR-related items in their annual reports even though these are not required by the Companies Act or the accounting standards. Moreover, in the study regarding the

prospects of HRA, Huang (1993) disclosure on HR could be made in the form of notes though it is not accounted in the traditional financial statements.

As mentioned above, human capital is a component of intellectual capital. Three common components of intellectual capital are human capital, organizational capital and customer capital. According to Brooking (1996: 15), human capital is human-centered asset and it is the 'collective expertise, creative capability, leadership, entrepreneurial and managerial skills embodied by the employees of an organisation'. A list of 20 human capital items (see Table 2) was compiled from indicators adopted by Brooking (1996), Edvinsson and Malone (1997), Roos et al. (1998), Christopher and Siu-Chung (1998) and Miller et al. (1999). This paper explores and examines the current scenario of Malaysian top companies on human capital reporting. It seeks to find out how these companies present their HR investment and their measures on these returns, if any. It specifically looks at the extent of disclosure of human capital information or items in the annual reports of these companies.

2. Methodology

This exploratory study first attempted to look at the annual reports of top 100 companies listed on the main board by *Bursa Malaysia* (formerly known as Kuala Lumpur Stock Exchange (KLSE)) based on market valuation.

The annual reports of top 100 companies listed on the main board were examined at the *Bursa Malaysia* web-site. However, one annual report was not available at the web. A letter was then posted to the company secretary requesting for its annual report. However, no reply was heard from the company concerned. Hence, it is excluded from the analysis. Another company too was excluded from the analysis since that particular company was dormant. Hence, only 98 companies' annual reports were reviewed.

2.1 Annual reports

Corporate annual report is generally accepted as the most comprehensive communication channel and has the potential to make information easily and routinely available in a single document (Hooks et al., 2002). It is one of the most comprehensive documents available in public. Annual report also represents the concerns and interests of corporations in a comprehensive and compact manner (Abeysekera and Guthrie, 2005).

Annual reports generally contain both quantitative and qualitative data. Both quantitative and qualitative human capital information is disclosed in the annual reports. Qualitative human capital information contains discourses on human capital and quantitative human capital information relates to employee turnover, staff costs, etc. Such human capital disclosure is non-standardized.

2.2 Content analysis

Researchers have sought to explain the extent of information disclosed in company annual reports by quantifying the level of disclosures by means of a disclosure instrument comprised of a list of items that could appear in the company's annual reports (Guthrie et al., 2003). A content analysis is a quantitatively oriented technique by which standardised measurements are applied to metrically defined units. This method is used to count the number of sentences containing, for example, the words 'human resources' and the number of pages devoted to 'human resources'.

Human capital disclosures using content analysis method were conducted by some researchers. These researchers adopted various criteria with the use of secondary sources such as the company's annual reports to justify the extent of disclosures. Among others, these were the approaches adopted:

(1) number of disclosures (Ness and Mirza, 1991);

(2) word counts (Zeghal and Ahmed, 1990);

(3) lines (Trotmen and Bradley, 1981);

(4) sentences (Hackston and Milne, 1996); and

(5) proportion of pages (Guthrie and Parker, 1989).

In this study, the disclosure on human capital or HR-related information is measured on a scale of one to five. The disclosure scores are as follows:

(1) for non-disclosure;

(2) for a disclosure of one to 20 words;

(3) for a disclosure of 21 to 50 words;

(4) for a disclosure of 50 to 100 words; and

(5) for a disclosure of more than 100 words.

3. Results and discussion

The results of this study are subject to several limitations. A limitation of the present study is that it relates to a single period. It was restricted to human capital information contained in the annual report of the top companies listed in *Bursa Malaysia* based on market valuation at a certain date. Therefore, it excluded other possible sources of disclosures such as, press news, flyers and stand-alone reports issued by these companies.

3.1 Samples

The 98 top Malaysian companies by market valuation were from the construction, consumer product, infrastructure project companies, trading/services, finance, industrial product, plantation, property and technology sectors. Twenty seven percent of these companies reviewed were from trading/services sector, follows by 21% from the finance sector, 17% from the consumer product sector and so on (Table 1).

3.2 Human capital items

The annual reports of these top companies were reviewed based on the list of 20 human capital items identified earlier. The results indicate that the disclosure practices of Malaysian top companies are low in relative to the total list of items. A total of 36 companies disclosed information on training and 31 companies reported on the development of their staff (see Table 2).

Descriptive information on training and human resource development was found to be the most disclosed in this study. Most companies reported the training programmes or activities in the annual reports. However, there was no report on training benefits are disclosed. This supports the findings from a study conducted by Huang et al. (1999) which found that human resource development such as staff training benefit is amongst the least disclosed information in the annual reports.

Information regarding employee skill, knowledge and competence was moderately mentioned I the annual reports. But, there is a lack of disclosure on information such as entrepreneurial spirit, teamwork, employee expertise, leadership, strategic relationship, etc.

Similar research was conducted in Bangladesh (Imam, 2000), one-third provided information related to health, safety and training in qualitative form. Only two companies provided information on the selection of employees. However, in Malaysia, such information is more general and no specific reference on selection of employees was disclosed in the annual reports.

Only one company has stated the term “balanced score card” which implied that this company could have employed this method to measure its human capital. Even though balanced score card is a method currently used in the west, it may not be employed by Malaysian companies.

Very few companies have disclosed human capital statistics (ratios or indicators) such as profitability per employee, sales per employee in the annual reports. Only five companies presented some HR statistics, mainly in the form of graphs.

On the whole, the disclosure of human capital or HR information is mainly qualitative in nature except for staff costs which are expensed in the income statements. Mainly discursive disclosures acknowledging the importance of staff are reported without mentioning of the returns on the investments on human capital.

3.3 Human capital disclosures by sectors

The disclosure of the above human capital items was further analyzed according to sectors (see Table 3). Out of the 20 human capital items, one from consumer product sector and the other from trading/services sector disclosed seven human capital items. One company from finance sector has disclosed six human capital items.

Out of the 98 companies, 42 companies did not disclose any human capital information or items listed. But, these companies did record their words of appreciation for their staff’s dedication and efforts. Fifty three companies disclosed between one to five human capital or HR items. Though these companies did report human capital, no elaborations were found with regards to their measurements. The low disclosure implies that companies are not transparent in human capital disclosures externally.

3.4 Word count

A word count was also conducted on the above disclosures. In each annual report, sentences containing words such as "employees", "staff", "people" (related to the company) were counted to capture the volume of HR-content. As mentioned above, the disclosure on HR-related information is measured on a scale of one to five.

Table 4 summarizes the mean disclosure of HR-related information by sectors. An overall mean of 3.78 was obtained. The mean disclosure for the construction, consumer product and infrastructure project companies are at 4 and above where as the technology and property sectors’ disclosure have the lowest means.

3.5 Location of disclosure of HR information

When conducting the content analysis of HR-related information, the location of such information was identified. More than 60% of the companies disclosed HR-related information in the Chairman's Statement with the main theme of thanking the employees for their contribution (see Table 5). The 'Chairman's Statement' seems to be the most important part of the annual report. Here the 'Chairman' expressed his view of the company's progress, main competitive advantages and results.

Sixteen companies disclosed human capital information in the operations review. Only 11% of the companies have a standing report on HR. They disclosed information ranging from HR processes, issues and strategies.

Table 5 reveals that the current disclosure of human capital information is found in different parts of the annual reports. It is difficult for external users to locate human capital information in the annual reports with the current reporting practice.

3.6 Staff costs

Staff costs are written off in the income statement in Malaysia. Table 6 summarizes the staff costs incurred by the top Malaysian companies by sectors. The highest staff cost incurred by the Malaysian top companies was from the trading/service sector amounted to M1.686 billion. Thirty six companies incur between RM1 to RM50 million each year on staff costs. A total of 11 companies spent more than RM400 million a year on staff costs. Three companies from trading/services and one from finance sectors, incurred between RM1, 001 to RM1, 500 million on staff costs a year.

Though Malaysian top companies on the whole spent quite a substantial amount of money on staff costs, they did not disclose information on the return on this expenditure. This could be because such expenditure is regarded as a cost rather than an investment. As most Malaysian top companies reported their training activities in their firms, the returns on such activities need further analysis. Guthrie (2001) argued that the traditional managing and reporting practices which regard of human resource development as a cost rather than an investment causes problem such as enterprises may be inclined to under-invest in training. This may contribute to recruitment and retention difficulties within the enterprise. This can also lead to an over-reliance on the public sector to support the required levels of training. Better ways of measuring and reporting human resources might therefore encourage greater private investment in education and training (Olsson, 1999; Boudreau and Ramstad, 1997; Lewis, 1997).

4. Conclusion

In general, the concept of HRCA is still distant to human resource managers in Malaysia. Much effort need to be put in to educate human resource managers on how to calculate human resource costs, values, ROI and its outcomes. If 'employee disclosure [are considered to] reflect the viewpoint that a company's continued success depend in part on its human resources' (Mueller et al p. 87, 1997), then we consider the management of these top Malaysian companies have not conveyed this message in full. The examination of the voluntary human capital reporting practices of top companies in Malaysia was found to be low. These top companies merely mentioned human capital items without elaborating on the measurement of such information as promoted by HRA or HRCA. Considerable improvement in the extent of disclosure for these top companies appears necessary to enhance transparency.

The implications of the findings, subject to the limitations of this study, are twofold. First, it appears that reliance on voluntary disclosure alone is unlikely to achieve high quality of disclosure either in the short or long term, at least not without some form of regulation or guidelines. Second, the results suggest that management may be either neglecting their most important resource or are unwilling to disclose this information. If the former is the case, this may eventually have undesirable consequences for the company such as preventing under-investments in training. The limitations of this study suggest some new directions for research. First, research into all the companies listed in KLSE would enhance the generalisability of the findings. Second, in order to demonstrate clear reporting patterns, a longitudinal study may provide further insights. Third, further study can be conducted to find out the current measurement methods employed to manage human resource in practice.

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Table 1. Samples by sectors

Sectors	Frequency	Percentage
Construction	5	5
Consumer Product	16	17
Infrastructure Project companies	6	6
Trading/Services	26	27
Finance	21	21
Industrial Product	11	11
Plantation	8	8
Property	3	3
Technology	2	2
Total	98	100

Table 2. Disclosure of human capital information

Item	Human Capital Information	Number of Companies
1	Training	36
2	Human resource development	31
3	Employee skill	24
4	Knowledge	17
5	Competence	17
6	Entrepreneurial spirit	6
7	Team work	5
8	HR statistics	5
9	Expertise	5
10	Leadership	4
11	Strategic relationship	3
12	Education	2
13	Human capital	2
14	Knowledge management	2
15	Intellectual capital	2
16	Vocation	1
17	Know how	1
18	Employee value	0
19	Expert team	0
20	Human asset	0

Table 3. Disclosure of human capital items by sectors (number of companies)

Sectors/No. of items	0	1	2	3	4	5	6	7
Technology	1			1				
Consumer product	7	1	3	1	3			1
Industrial product	6	1	1	1	1	1		
Construction	1			2	1	1		
Trading/services	9	3	4	5	3	1		1
Finance	13	2	1	2	2		1	
Property	1			2				
Plantation	2	2	1		2	1		
Infrastructure project companies	2			2		2		
Total	42	9	10	16	12	6	1	2

Table 4. Level of disclosure (mean) by sectors

Sectors	Mean
Construction	4.20
Consumer Product	4.00
Infrastructure Project companies	4.00
Trading/Services	3.92
Finance	3.71
Industrial Product	3.64
Plantation	3.63
Property	2.67
Technology	2.50
Overall	3.78

Table 5. Location of Disclosure of HR Information

Location in the annual report	Number of companies	Percentage
Chairman's Statement	59	60.2
Operations Review	16	16.3
Standing Report on HR	11	11.2
Managing Directors' Review	5	5.1
CEO's Report	2	2.0
Non Disclosure	5	5.1
Total	98	100

Table 6. Staff costs incurred by sectors (number of companies)

Sectors/Staff costs (million)	0	1-50	51-100	101-150	151-200	201-250	251-300	301-350	351-400	>400
Technology		1					1			
Consumer product		2	4	1	4	2	1		1	1
Industrial product		4	3	2					1	1
Construction		3	2							
Trading/services		13	3	1	1	1	1	1	1	4
Finance	1	5	3	3	1	2	1	1		4
Property		3								
Plantation		2	2	1	1		1		1	
Infrastructure project companies		3	1	1						1
Total	1*	36	18	9	7	5	5	2	4	11

* One company did not disclose staff costs.