FINANCIAL MANAGEMENT DEVELOPMENT

DISCUSSION TOPICS

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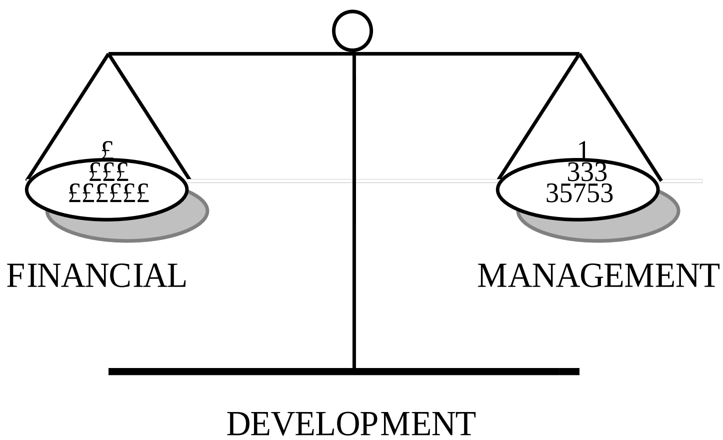
INVESTORS IN PEOPLE
A contradiction in terms?



ONE OF A SERIES OF GUIDES FOR

FINANCIAL MANAGEMENT DEVELOPMENT

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This is one of a series of documents produced by David A Palmer as a guide for managers on specific financial topics to assist informed discussion. Readers should take appropriate advice before acting upon any of the issues raised.

INVESTORS IN PEOPLE
A contradiction in terms?

INVESTMENT IS A FINANCIAL TERM - PEOPLE ARE HUMAN RESOURCES

Many noteworthy organisations in the UK have striven to acquire IIP the accolade of Investors of People. Unfortunately, judging from published Financial Accounts, none of them deserve the title.

In published company accounts assets are shown in the Balance Sheet. Many organisations claim that people are their greatest asset. Yet the Balance Sheet remains unsullied by either the value of those assets or the cost of the Investment in them. Since the accounts are accompanied by an Audit Report which confirms their truth and fairness it cannot be a mistake, this is a deliberate omission.

For how much longer can the Personnel and Finance functions continue to ignore each other? Either people are an asset, in which case they should be shown on the Balance Sheet; or they are not, in which case let us stop referring to investing in them. Either training is an investment for the future, in which case it adds to the value of the asset; or it is a cost of running the business and is correctly charged against profits. If published accounts treat training as a cost and people as valueless surely they are grossly misleading?

Perhaps the HR Director and the Finance Director should discuss this at the Board Meeting to approve the Annual Accounts. Especially as the Directors (i.e. all Directors and yes that does include the Non Executives!) are required to prepare financial statements which give a true and fair view of the company's state of affairs. This paper aims to shed some light on the issues involved to help the HR Director in those discussions. The Finance Director should know them already.

THE PROBLEM AND THE FIVE ACCOUNTING CONCEPTS

To understand the anomaly it is necessary to understand a small amount of accounting theory. To Personnel professionals this may sound daunting. However, the rewards are there. Remember the finance function hold the purse strings, knowing which string to pull will help to unloosen them.

Accountants have five basic concepts underlying all that they do. (The same number as fingers on one hand). These are:

1. **<u>Prudence</u>**. Always fear the worst. No one gets fined, sacked, sued for understating profit. See Enron for an example of failing to adhere to this.

2. **<u>Going Concern</u>**. Assume that the organisation will continue in being. This avoids overdoing the first concept.

3. **<u>Accruals</u>**. Try to match income and costs to the same period of account to calculate the profit. Profit is defined as Sales less the costs of achieving the sales. Most accounting disasters arise from failing to match income and costs in the same accounting period. (See Pension provision debate 2002-??)

4. **<u>Separability</u>**. Individual transactions should not be netted off. Otherwise the accounts would consist of two numbers - net profit in the Profit and Loss Account and net worth in the Balance Sheet. Net worth is defined as assets less liabilities.

5. **<u>Consistency</u>**. The rules should not be changed too often. It is better to be consistently wrong than to try to improve things. Random treatment of the value of football players' transfer fees (treat as fixed asset and depreciate; treat as stock; or write off against profit) shows what can happen if you try to be realistic about Human Asset Accounting.

These rules are enshrined in the Companies Acts and should be sufficient to account for any transactions. They have served accountants well for over five hundred years, since a Franciscan monk documented them. Unless managers from other functions deliberately mislead them, accountants can draw up accounts on the basis of these principles knowing that they will be true and fair. The fact that they are totally unintelligible to the rest of the population is not the accountant's fault. (See for example the Cashflow Statement or the Notes on Pensions in any public company accounts.) Surely no good Director would approve a set of Accounts that they did not understand?

Problems only occur when operational managers refuse to explain what they are doing and accountants are unable to apply the five concepts. "Derivatives are much too complex, if we applied the prudence concept we would not show a profit." "We don't know how much pension costs will be (or in the US post retirement healthcare benefits) but the employees like them so we will wait until we know before charging them against profit". The eventual result of such a failure of communication is a retrospective charge which wipes out profits and allows the accountants to say "I would have told you so".

Investing in people is a worthwhile use of corporate funds. The HR Industry needs to ensure it is properly accounted for. For a start all costs in gaining IIP status should be considered for inclusion on the Balance Sheet and written off over an appropriate period. This concept might then be applied to other similar "Investment in People" costs and some start might be made on true asset values and true return on on investment. In time, management accounts should also show the value of people managed; not just their cost - but that is another story.

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David is an experienced financial professional who has devoted his skills to management training in practical understanding and utilisation of financial information. A Graduate, Chartered Accountant, and Associate of the Institute of Taxation, he is also a Member of the Chartered Institute of Personnel and Development and has been an Ordained as a Deacon in the Catholic Church.

He has worked as a Financial Controller and Company Secretary in the Finance industry and as a Director of Finance and Administration in the Computer Services industry. Since 1990 he has conducted management development programmes for over forty major organisations including Arla Foods, Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, Royal Mail, Unilever and Zeneca. He also runs programmes for the Leadership Foundation and the management teams at a number of Universities. International training experience includes work in Belgium and Holland for CSC, in Denmark, Kenya and the Czech Republic for Unilever, in Holland and the US for Zeneca, in Dubai for Al Atheer, in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. In addition he has run courses in acquisition evaluation (The Economist, Eversheds, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). All training is specifically tailored to the needs of the organisation with the emphasis on practical applications to enhance profitability and cashflow. He has developed material for delivery by in-house personnel (Royal Mail, Lloyds Bowmaker and Conoco), computer based training packages (The Post Office, Unilever and BP), and post course reinforcement self-study workbooks (CSC and Zeneca). He has also produced a training video on Cashflow Management.

He is a prolific writer of case studies, role plays and course material. He has also published articles on the financial justification of training, financial evaluation of IT investment proposals, the use of Activity Based Costing and Customer Profitability statements, commercial considerations for consultants, the need for taxation awareness training for general managers, evangelisation and Christian business ethics.

Many of his generic documents are freely available on his website:
FinancialManagementDevelopment.com including papers on Charity Management.

In addition to his Diaconal work in the Church, he has held a number of voluntary positions including University, College and School Governor, Hospice Treasurer and Trustee of various charitable institutions. He continues to provide ad hoc commercial advice to several other charitable organisations. He has been married for over 35 years and has one daughter and three granddaughters.

This series of papers is designed to help managers by providing a basic understanding of key financial concepts to assist them in their work. It is provided at no cost since this knowledge is a Gift from God and thus to be shared (Matthew 10:8).

