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BUSINESS SCHOOL

Recognizing non-compete agreements as intangible assets: A proposal for capitalizing human capital

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Problem

- Unrecognized intangibles argued to be driver of firm value
- Increasing difference between balance sheet and market value – 'missing gap' especially in the information age
- Impacts financial analysis (e.g. assets and earnings are understated)
- One important intangible is People
- Anecdotal: Company's No. 1 Asset is people
- Empirical: Human capital is associated with firm value
- IASB (2025) survey: 69% of users say f/s have insufficient information on human capital

Solutions?

- EFRAG and SEC propose disclosure driven solutions (KPIs)
- ISSB has an ESG lenses of disclosures
- Disclosure driven solutions don’t solve missing gap – recognition vs disclosure literature
- Capitalizing all expenditure related to intangibles is unlikely to gain support from a broad constituent group
- Training expense doesn’t provide data on high value employees
- “..accounting for intangibles needs improvement, yet views differ on both the problems and their solutions” (Barckow, 2024)

Literature review

- Intangible assets are value relevant and so are uncapitalized software costs and research expenses
- Estimates of internally generated intangibles expenditure are useful
    - Related expenditure as a function of revenue is useful (Enache and Srivastava 2018, Iqbal et al., 2025)
    - Regier and Rouen (2023) find that employee costs as a function of revenue and find it is value relevant.

Human Capital exception

- Unlikely to see Human Capital on B/S
- Football players – controlled by an entity as a result of past events; probable future economic benefits (hopefully), cost can be measured reliably (and directly), arises from contractual rights
- So when else could we see humans on the balance sheet per current GAAP?

	2024 No.	2024 £000	2023 No.	2023 £000
The number of players with a book value in excess of £1m by contract expiry date is as follows:				
Contract expiry within 1 year	-	-	1	1,200
Contract expiry within 2 years	**1**	**1,846**	2	3,857
Contract expiry within 3 years	**8**	**14,988**	3	8,927
Contract expiry within 4 years	**1**	**2,339**	4	8,392
Contract expiry within 5 years	**1**	**4,035**	-	-
	11	**23,208**	10	22,376

No individual intangible asset included above accounted for more than 14% of the total net book value of the intangible assets (2023: 17%).

Non-compete agreements

- Restrict employees from starting a competing business or working for competitors for a period of time (or approaching customers, co-workers etc)
- Often bundled with non-disclosure agreements
- To be enforceable must be reasonable in scope and do not apply immediately
- About 1 in 5 usage in US and Australia, 37% of high skilled workers in Finland

NCA as an asset?

- Identifiable as arises from a legal contract
    - IFRS 3 (Consolidations) basis of conclusions has non-competes as an example of an identifiable intangible assets acquired in a business combination
- Directly measurable and attributable as proportion of salary
- Probable benefit from reduced product market competition
    - IAS 38.17 allows for benefits beyond cash realizability and IFRIC (2010) says restraining an employee from working for a competitor is a benefit (under share based payments) + anecdotally can be bought out
- Arise from a past event and present control is enforceable
- Non-competes also meet the idea that any employee asset should be valued/unique and can be kept out of the reach of competitors
- Narrow in scope + most similar to football?

Research Question

- Narrow class of identifiable investments that are more likely to satisfy existing IASB recognition criteria*
- How does it change reported numbers? (stewardship, debt contracting)
- Does it improve the usefulness of reported numbers?

RQ: What is the impact of recognizing a non-compete asset on the financial statements??

The Debits and Credits

Dr. Employee Costs 100
Cr. Cash 100

Assume $30 of Employee costs are subject to a 6 month non-compete which activates over 2 years
Dr. Employee Costs 92.5
Dr. Non-Compete Asset 7.5*
Cr. Cash 100
*potential capitalized costs x non-compete period x vesting period

- 30 x 6/12 x 1/2= 7.5 = capitalizable amount

Setting and sample

- NZ
- ISAs, IFRS, similar policy settings
- Must disclose number of employees that earning above 100k, in 10k bands
- This granular disclosure is important as it allows a firm specific estimate of those who could be subject to a non compete agreement – unique and highly value employees

- Start with all NZX companies, exclude shells, no data, no high earners – 75 observations in 2018-2024 = 450 obs).

TEAM MEMBERS' REMUNERATION

Grouped below are the number of team members or former team members, not being Directors or former Directors, who received remuneration and other benefits valued at or exceeding $100,000 during the period 1 August 2022 to 30 July 2023.

Remuneration includes redundancy payments and termination payments made during the year to team members whose remuneration would not otherwise have been included in the table reported below.

Remuneration ($ 000)	Number of Team Members
100 - 110	132
110 - 120	103
120 - 130	100
130 - 140	81
140 - 150	81
150 - 160	50
160 - 170	24
170 - 180	47
180 - 190	41
190 - 200	16
200 - 210	13
210 - 220	19
220 - 230	13
230 - 240	6
240 - 250	8
250 - 260	5

Remuneration ($ 000)	Number of Team Members
260 - 270	4
270 - 280	6
280 - 290	6
290 - 300	1
300 - 310	4
310 - 320	4
320 - 330	1
330 - 340	7
340 - 350	1
350 - 360	1
360 - 370	2
370 - 380	2
390 - 400	3
400 - 410	1
410 - 420	3
420 - 430	1

Remuneration ($ 000)	Number of Team Members
430 - 440	1
440 - 450	1
590 - 600	1
620 - 630	1
670 - 680	1
680 - 690	1
730 - 740	1
770 - 780	1
890 - 900	1
1,030 - 1,040	1
1,070 - 1,080	1
1,100 - 1,110	1
1,120 - 1,130	1
2,790 - 2,800	1

Method

- Follow lease capitalization literature - recalculate numbers under our proposal and test if ratios and value relevance changes
    - Assume six month non-enforce period (standard in NZ),
    - Those earning over $130,000 have a non-compete (proposed threshold and double average salary)
    - Two year vesting period
    - Amortized over 6 years (turnover rates)
    - 40% Accum dep OB (Mehnaz et al. 2024)
- Capitalized amount for each year is then subtracted from employee costs and added to profit
- Amortized, subtracted from profit
- Equity is adjusted

Estimation procedure

Initial OB:

- *Non-compete asset$_{p-1}$ = (potential capitalized costs$_{p-2}$ ×6/12) + (potential capitalized costs$_{p-1}$ - potential capitalized costs$_{p-2}$ × 6/12 × 1/2).*

Onwards example

- *Non-compete asset$_{p+3}$ = Non-compete asset$_{p+2}$ + (potential capitalized costs$_{p+3}$ - potential capitalized costs$_{p+2}$ × 6/12 × 1/2) + (potential capitalized costs$_{p+2}$ - potential capitalized costs$_{p+1}$ × 6/12 × 1/2)*

	Mean	Median	Minimum	Maximum
Pre-capitalization (‘000)				
Total Assets	1990000	581000	5201	15800000
Total Equity	872000	290000	-5658	8610000
Total Intangible Assets	194000	46800	0	5510000
Total Operating Expense	883000	271000	3411	13700000
Employee Costs	152000	75000	1276	1660000
New accounts (‘000)				
Non-Compete Asset	30300	13500	0	556000
Post-capitalization (‘000)				
Total Assets	2000000	588000	5228	16000000
Total Equity	889000	297000	-5616	8640000
Total Intangible Assets	211000	56700	0	5650000
Total Operating Expense	880000	269000	2977	13700000
Employee Costs	148000	72400	-17000	1640000

Leverage (Total Liabilities/Total Assets)				
Pre-capitalization	0.493			
Post-capitalization	0.482			
t-test	10.925***			
ROA (EBIT/Total Assets)				
Pre-capitalization	0.047			
Post-capitalization	0.052			
t-test	-5.543***			
Intangibles to Asset (Intangible Assets /Total Asset)				
Pre-capitalization	0.175			
Post-capitalization	0.192			
t-test	-14.516***			
MTB (Market value/Book value of equity)				
Pre-capitalization	2.635			
Post-capitalization	2.447			
t-test	4.946***			

Sensitivity tests

Similar inferences by year and industry

	Leverage	ROA	Intangibles to Asset	MTB
Pre-capitalization	0.493	0.047	0.175	2.635
$NZ200,000 threshold	0.486	0.050	0.185	2.492
$NZ300,000 threshold	0.489	0.049	0.181	2.577
Double average salary threshold	0.484	0.049	0.188	2.478
3 month non-compete period	0.487	0.050	0.184	2.533
12 month non-compete period	0.472	0.056	0.208	2.310
No ramp up	0.485	0.050	0.187	2.473
3-year ramp up	0.481	0.053	0.194	2.343
4-year useful life	0.482	0.052	0.191	2.456
8-year useful life	0.480	0.053	0.194	2.428
No amortisation	0.475	0.054	0.203	2.335
30% OB Accum. Amort.	0.479	0.054	0.197	2.424
50% OB Accum. Amort.	0.480	0.054	0.195	2.447

Value relevance tests

Price = NI + BVE *(reported accounting numbers)*

VS

Price = NI + BVE** *(recalculated accounting numbers)*

Test whether the mean squared errors differ significantly to see if capitalising non-compete agreements results in accounting better explaining firm value

- *Price* is share price 3 months after balance date
- *NI* is the reported net profit after tax deflated by shares
- *BVE* is the book value of equity deflated by number of shares
- Include year and industry fixed effects
- Data from Refinitiv Eikon

Descriptive stats

Adjusted numbers are 'better'

Variable	Mean	Median	SD	Min	Max
Price	4.790	2.624	7.255	0.054	43.200
NI	0.181	0.106	0.389	-0.838	1.868
BVE	2.304	1.582	2.484	0.003	13.830
NI*	0.192	0.116	0.396	-0.842	1.858
BVE*	2.369	1.648	2.530	0.003	14.139

	Full Sample	
	Price	*Price*
Constant	-0.354	-0.385
NI	6.857***	
BVE	1.270***	
NI*		6.740***
BVE*		1.250***
Year FE	Yes	Yes
Industry FE	Yes	Yes
F	55.32	56.59
Adjusted R2	0.611	0.617
N	450	450
Paired t test	0.458***	
Mean diff in MSEs	(4.467)	

Capitalizing non-compete clauses explains more of firm value

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	High Intang		Low Intang		High_HCI		Low_HCI	
	Price	*Price*	*Price*	*Price*	*Price*	*Price*	*Price*	*Price*
Constant	0.588	0.584	2.614***	2.570***	0.005	0.047	-0.566	-0.627
NI	9.257***		5.136***		3.244*		8.499***	
BVE	1.220***		0.352***		1.660***		1.122***	
NI*		8.848***		5.042***		3.613*		8.163***
BVE*		1.177***		0.346***		1.592***		1.130***
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
F	42.14	43.57	14.56	14.72	21.74	22.73	60.97	60.03
Adjusted R2	0.828	0.833	0.614	0.616	0.546	0.558	0.672	0.668
N	112	112	112	112	156	156	294	294
Paired t test	1.379***		-0.012		1.295***		-0.415***	
Mean diff in MSEs	-2.781		(-0.223)		-3.615		(-2.915)	

Robustness

- Vary assumptions
- Isolating the NCA as a separate variable
- Controlling for employees
- Vuong test

Costs

- Non-competes can reduce labour mobility and innovation
- Comparability between countries depends on use of non-competes
- Earnings management opportunity? – would be a real earnings management as tied to actual non-compete in practice?
- Complex/Audit fees?

Conclusion

- Longstanding debate on the 'missing gap'
    - Expenditure related to intangibles is associated with firm value (e.g. Enache and Srivastava 2018; Banker et al. 2019; Regier and Rouen 2023)
- Argue for a specific new intangible asset (Non-Compete Asset)
- A small but systematic proposal grounded in the current standard
    - Contribute to debate with differing views and promote discussion on intangible asset accounting
- Improves ratios and reduces 'missing gap'
- Improves usefulness of accounting in knowledge driven firms
- Have we created a monster?