

# How to approach the SEC's new human capital disclosures

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**In August, when it streamlined the requirements for business, legal proceedings and risk factor disclosures under Regulation S-K, the Securities and Exchange Commission (SEC) introduced an important new requirement. Registrants will now have to provide a description of human capital resources to the extent material to an understanding of their business.**

Various investor groups have been pushing for these types of disclosures, underscoring the growing recognition that human capital is a key driver of long-term value. This new requirement will likely impact most registrants, given the significance of human capital to the operations and strategy of most companies.

This document provides an approach for registrants to consider as they begin planning to meet the SEC's new requirement.

***The rule says a registrant must disclose “a description of the registrant’s human capital resources, including the number of persons employed by the registrant, and any human capital measures or objectives that the registrant focuses on in managing the business (such as, depending on the nature of the registrant’s business and workforce, measures or objectives that address the development, attraction and retention of personnel).”***

The new rule, like the other changes the SEC made to its disclosure requirements, uses a principle-based approach, and it does not define the term “human capital.” The SEC indicated that the “term may evolve over time and may be defined by different companies in ways that are industry specific.” Further, the SEC acknowledged that the measures and objectives registrants disclose will be entity specific and can vary across sectors, businesses and workforce types. The SEC also indicated that it expects these disclosures to evolve over time as practice, managerial activities and business environments change. As such, these disclosures as well as the accompanying metrics and measures will likely vary among companies and across sectors.

These new requirements will be effective for annual reports and registration statements filed 30 days after the date the final rule is published in the Federal Register.

The rule employs a “management approach” that the SEC has used in the past when requiring disclosure about key performance indicators in management’s discussion and analysis.<sup>1</sup> However, the SEC did not define in either case what it meant by “managing the business,” so registrants must use considerable judgment to determine the appropriate measures or objectives. It may be helpful for them to consider other established models to inform their approach to human capital disclosures.

One such model is the management approach used by the Financial Accounting Standards Board (FASB) in its standard on segment reporting.<sup>2</sup> It requires public companies to base their segment reporting disclosures on information about operating results that is regularly provided to the chief operating decision maker, a role filled by one or more individuals responsible for evaluating the performance of and allocating resources to a company’s operating segments.

<sup>1</sup> See SEC Release No. 33-8350, *Commission Guidance Regarding Management’s Discussion and Analysis of Financial Condition and Results of Operations*.

<sup>2</sup> See Accounting Standards Codification 280



We believe that focusing on human capital information that is regularly used by management to evaluate performance and allocate resources within a company may be a good starting point. In addition, we believe that a registrant should consider information provided to the board of directors and other stakeholders so that the disclosures are complete. Accordingly, a registrant may consider information provided to the executive committee, the general counsel or members of the C-suite.

The following questions could be considered to help develop disclosures in response to the final rule.

**Key questions include:**

- ▶ What human capital objectives have been established by the organization to help management evaluate performance and allocate resources?
- ▶ What human capital measures are provided to management?
- ▶ What decisions made by management are influenced by these objectives and measures, and how?
- ▶ What goals, strategies, or targets have been set for executives in charge of human resources (e.g., chief human resources officer) to help management evaluate performance and allocate resources?
- ▶ What human capital measures and objectives have been provided to the full board of directors or its various committees?
- ▶ How are human capital objectives and measures linked to management’s performance goals and compensation?
- ▶ What key human capital objectives and measures are shared with key stakeholders (e.g., as onboarding materials for new employees, in corporate sustainability reports, in marketing materials, in communications with rating agencies and regulatory bodies)?
- ▶ Are there other broader human capital objectives or other measures that are important to the organization’s overall corporate strategy, mission and vision?

**Governance**

While the information to be disclosed may currently be shared with management or disclosed elsewhere (e.g., in corporate sustainability reports, in marketing materials), an important distinction is that this information will now appear in SEC filings. Registrants can face significant liability under federal securities laws if the information in its SEC filings is found to be misstated or if required information is omitted.

The new disclosures are also subject to disclosure controls and procedures (DCPs) that registrants are required to have in place to make sure that all of the information required in their SEC filings is reported accurately and timely. Each quarter, a registrant also must disclose whether its DCPs are effective, and the chief executive and chief financial officer each take responsibility in a signed certification required by the Sarbanes-Oxley Act for the design and evaluation of the DCPs.

As a result, management should develop robust governance policies regarding this new information.

**Key questions include:**

- ▶ Where does the data reside for the relevant human capital measures?
  - ▶ Is it prepared internally or externally? If it is prepared internally, is it centrally located or does it need to be compiled from various locations manually?
- ▶ What DCPs, if any, currently exist for human capital measures?
- ▶ What additional DCPs would be needed to meet the SEC requirements?
- ▶ What controls are necessary to make sure that measures are calculated consistently or that any changes to the methodology are disclosed?
- ▶ What processes need to be put in place to make sure that the new information can be added to the annual report without slowing preparation?
- ▶ What functions are needed on a cross-functional team to review the disclosures and close any gaps?
  - ▶ Project management (now and on a recurring basis)
  - ▶ External reporting
  - ▶ Investor relations (IR)
  - ▶ Legal
  - ▶ HR
  - ▶ IT



## Reporting and communications

Many investor groups have been calling for expanded human capital disclosures for some time, and these new disclosures will receive significant attention from key stakeholders. As such, this may also be an opportunity for companies to further enhance their disclosures by discussing their plans and strategic strengths associated with human capital placed in the context of their business objectives and strategies. These are increasingly important as greater emphasis is placed on the role of human capital in underpinning and enhancing long-term value – especially in those sectors that are highly dependent on skilled, well-developed and engaged personnel.

### Key questions include:

- ▶ How can we maximize the impact of our human capital management reporting and processes?
- ▶ How can we optimize the impact on our brand and reputation, including with prospective employees, our communities, customers and key stakeholders?
- ▶ How can we make sure our messaging is consistent in IR decks, social media, our website, our corporate sustainability report, our Form 10-K and our proxy statement?

Examples of measures, objectives and strategies that companies might disclose include:

- ▶ Overarching human capital resource strategies, goals and management
- ▶ Employment and recruitment strategies and practices
- ▶ Diversity and equality
- ▶ Employee retention strategies, goals and measures
- ▶ Compensation and incentive mechanisms
- ▶ Employee benefits, collective bargaining and grievance mechanisms
- ▶ Employee engagement
- ▶ Investment in employee training
- ▶ Employee health and well-being
- ▶ Succession planning
- ▶ Legal or regulatory proceedings related to employee management

The [Embankment Project for Inclusive Capitalism](#) provided some helpful detail about metrics of interest to stakeholders, including investors. We believe the project may help companies decide which of their existing metrics will resonate with their investors. Companies that take this opportunity to expand their use of human capital metrics may also find it helpful.

Created by the Coalition for Inclusive Capitalism and the EY organization, this project brought together companies, asset managers and asset owners, representing \$30 trillion of assets under management and almost 2 million employees around the world to help frame long-term value communications between market participants. Feedback from both reporting companies and investor representatives on potential human capital metrics that could be provided is listed below. Additionally, many investors are requesting that companies consider sector-specific metrics (including human capital) issued by the [Sustainability Accounting Standards Board](#).

## Category: human capital deployment

A company's ability to deploy the knowledge, skills and capabilities of its workforce

Human capital deployment dimension	Example metrics
<b>Workforce cost</b>	<ul style="list-style-type: none"> <li>▶ Total sum of gross salaries, bonuses and pension benefits of all company employees</li> </ul>
<b>Attraction, recruitment and turnover</b>	<ul style="list-style-type: none"> <li>▶ Percentage of employee annual turnover</li> <li>▶ Percentage of voluntary turnover in relation to overall turnover</li> <li>▶ Percentage of voluntary turnover of high performers</li> </ul>
<b>Workforce composition and diversity</b>	<ul style="list-style-type: none"> <li>▶ Leadership diversity (e.g., gender, race) by rank (board, top leaders, management)</li> <li>▶ Ratio of full-time to part-time labor</li> </ul>
<b>Training, learning and development</b>	<ul style="list-style-type: none"> <li>▶ Return on investment in talent</li> <li>▶ Total annual training hours received per employee (per type)</li> <li>▶ Total spend on training per employee or per hour</li> </ul>

## Category: employee health

The health and well-being of a company's workforce

Employee health dimension	Example metrics
<b>Engagement and well-being</b>	<ul style="list-style-type: none"> <li>▶ Engagement index score</li> <li>▶ Absenteeism rate as a percentage of total hours worked</li> <li>▶ Mental health well-being rate</li> <li>▶ Percentage of employees participating in "best practice" health and well-being program</li> </ul>

## Category: organizational culture

The culture of the company and its alignment with a company's stated purpose, often expressed as infographics showing responses to employee survey questions

Organizational culture dimension	Example employee survey responses
<b>Ethics and integrity</b>	<ul style="list-style-type: none"> <li>▶ I feel encouraged and supported to speak up.</li> <li>▶ I feel conflicted between doing the right thing for our external stakeholders and performing to meet business expectations.</li> </ul>
<b>Alignment with purpose and values</b>	<ul style="list-style-type: none"> <li>▶ I feel there is a common understanding as to our purpose as an organization.</li> <li>▶ It is clear to me how my work contributes to our stated purpose.</li> </ul>
<b>Leading by example</b>	<ul style="list-style-type: none"> <li>▶ Based on my experience, leadership consistently demonstrates the organization's stated values in everyday behavior.</li> <li>▶ Based on my experience, leadership engages with the workforce about our culture and values in a meaningful way.</li> </ul>
<b>Performance and accountability</b>	<ul style="list-style-type: none"> <li>▶ I am clear on what is expected of me from a performance perspective.</li> <li>▶ I receive timely feedback that strengthens my performance.</li> </ul>
<b>Inclusion and well-being</b>	<ul style="list-style-type: none"> <li>▶ I feel that I have an appropriate work-life balance.</li> <li>▶ I feel support in developing my long-term career.</li> </ul>

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