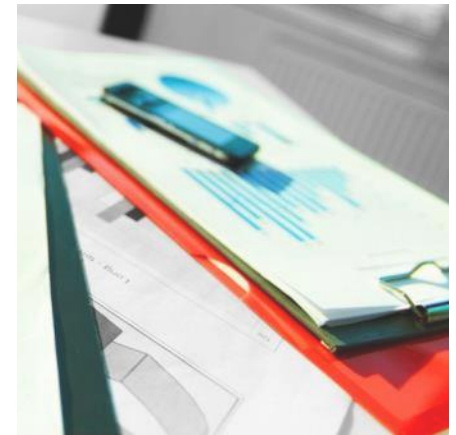


*Companies Must  
Begin to Disclose  
Important  
Information about  
Employee Attraction,  
Development and  
Retention*



**David Vance**  
**Executive Director**

# *SEC Just Mandated Public Disclosure of Human Capital Information*



- The US Securities and Exchange Commission (SEC) published its final rule on August 26 mandating human capital disclosure
  - » Congressional approval not required
  - » Rule became effective November 9 – no grace period
    - Quarterly and annual disclosures now need to incorporate this rule
- Rule will impact publicly traded companies first but eventually will impact all organizations including privately held for-profits, nonprofits, educational institutions, and government institutions

# *SEC Background*

- The SEC was created in 1934 to regulate companies that sell securities to the public
- It requires disclosure of information that investors need to know before buying or selling a security (stock, bond, or derivative)
- There was strong resistance at the time from companies to disclose what they believed to be confidential information

# *SEC Background (continued)*



- The disclosure rules have been updated several times since then with the last major update in 1977
- Currently, companies must publicly comment on 12 items in the narrative that accompanies financial statements
- Only one of these is related to human capital: number of employees
- Part of a broader update called Modernization of Rule S-K, which governs disclosure requirements for initial offerings (S-1), quarterly reports (10-Q), and annual reports (10-K)

# *Examples of the 12 Items That Must Be Disclosed Today*



- Principal products and services
- New products and segments
- Competitive conditions
- Seasonality
- Backlog of orders
- Sources and availability of raw materials
- Number of employees

# *The SEC Proposal to Fundamentally Change Reporting*

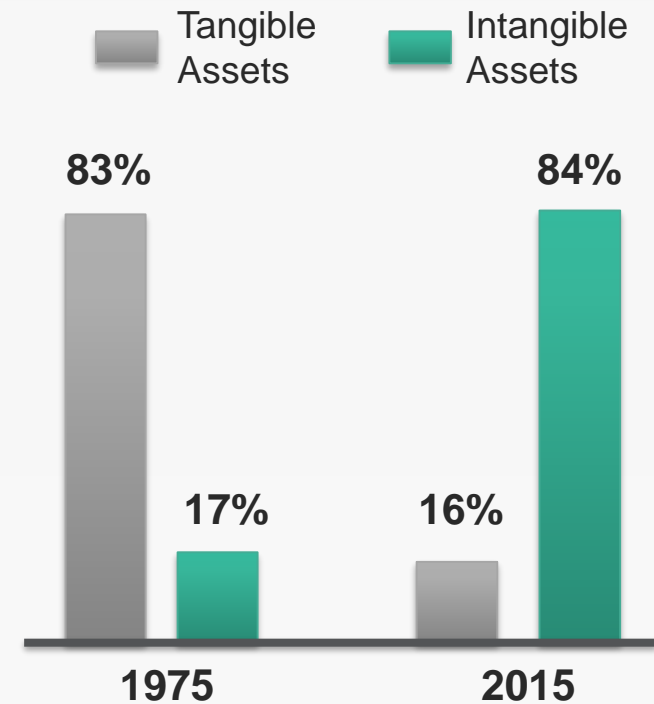


- Adopt a principles-based approach where material information must be disclosed
  - » Contrasts with prescriptive approach to disclose 12 items
  - » Reflects rapid pace of change
- Disclose material information on human capital
  - » For attraction, development and retention, at a minimum

# *Human Capital Is Now Far More Important than Physical Capital*



**% of Valuation on the Balance Sheet for S&P 500 Companies**



Source: Ocean Tomo, LLC

- Tangible assets
  - » Physical capital
    - Land, machinery, equipment
- Intangible assets
  - » Difference between the value of a company (stock price x shares) and its tangible assets
  - » Equals human capital

# *The SEC Final Rule for Human Capital Disclosure*



“...will require to the extent such disclosures would be **material** to an understanding of the registrant’s business taken as a whole, a **description of the registrant’s human capital resources**, including in such description any **human capital measures or objectives** that management focuses on in managing the business.” (page 52)



# *Key is Materiality*



- Information is material if an investor would want to know it before buying or selling a security
  - » Examples
    - HR initiatives
      - Plans to hire or lay off large numbers of employees
      - Change in total compensation system
      - Change in the performance management process
    - HR metrics examples
      - Diversity
      - Hiring
      - Retention
      - Engagement and leadership scores

# *From a Risk Mitigation Perspective*



- The primary risk is being sued by an investor for failure to disclose material information on human capital – the driving factor today in most companies performance and stock price
- SEC can also take administrative action
- Companies may choose to use ISO standards as a starting point
  - » Especially the 23 measures recommended for external reporting by large organizations

# *Where Can Companies Find Guidance to Mitigate Their Risk?*



- The International Organization for Standardization (ISO) published the first Human Capital Reporting standards in December 2018
- 60 measures recommended for internal and external reporting
  - » 23 measures for external reporting by large organizations
- Reporting is voluntary although some countries will mandate it

# *ISO Human Capital Reporting Effort*



- Culmination of three year's work by large multinational team led by Stephanie Becker (Deutsche Bank – Berlin)
- Followed an unsuccessful effort by SHRM in 2012 to identify six human capital measures for voluntary disclosure
- Measures chosen from both an investor and employee viewpoint

# ISO Recommended Measures



<u>HR Cluster</u>	<u>Large Organizations</u>		<u>Small and Medium Organizations</u>	
	<u>Internal</u>	<u>External</u>	<u>Internal</u>	<u>External</u>
Compliance and ethics	5	3	4	1
Costs	7	1	4	1
Diversity	5	5	4	0
Leadership	4	1	0	0
Organizational culture	2	0	2	0
Organizational health, safety, well-being	4	3	3	2
Productivity	2	2	2	2
Recruitment, mobility, turnover	16	5	3	1
Skills and capabilities	5	1	3	1
Succession Planning	5	0	2	0
Workforce availability	<u>5</u>	<u>2</u>	<u>5</u>	<u>2</u>
<b>Total</b>	<b>60</b>	<b>23</b>	<b>32</b>	<b>10</b>

# *Ten Measures for External Reporting by all Organizations*



- Total workforce cost
- Human capital ROI, Revenue or profit per employee
- Turnover rate
- Development and training cost
- Number of accidents, Number killed during work
- Number of employees and FTEs
- Percentage of employees who have completed training on compliance and ethics

# *Thirteen Additional Measures for External Reporting by Large Organizations*



- Workforce diversity (4 measures) by
  - » Age
  - » Gender
  - » Disability
  - » Other
- Diversity of leadership team
- Leadership trust
- Time to fill vacant positions
- Time to fill critical vacant positions

# *Thirteen Additional Measures for External Reporting by Large Organizations (cont.)*



- Percentage of positions filled internally
- Percentage of critical positions filled internally
- Number and type of grievance filed
- Number and type of concluded disciplinary action
- Lost time for injury



# *Focus on Key Measures: Total Workforce Cost*

- How much is the organization spending on people?
  - » Internal workforce
    - Full and part-time employees
  - » External workforce
    - Contractors
    - Temporary work force: leased and agency workers, interim workers
- Costs to be included
  - » Internal workforce: Salaries + benefits
  - » External workforce: Amount paid

# *Focus on Key Measures: Human Capital ROI*

- A measure of the amount returned for every dollar spent on human capital
  - » Like profit per employee, an indicator of productivity
  - » Similar to financial ROI (Net Profit / Investment)
- Human capital ROI = Net profit from human capital / Investment in human capital
  - » The “net” in the numerator means the cost of human capital needs to be subtracted
- By formula,
  - »  $\{[\text{Revenue} - (\text{Expenses} - (\text{Pay} + \text{Benefits}))] / (\text{Pay} + \text{Benefits})\} - 1$

# *Focus on Key Measures:*

## *Human Capital ROI (continued)*

- Human capital ROI =  $\{[\text{Revenue} - (\text{Expenses} - (\text{Pay} + \text{Benefits}))] / (\text{Pay} + \text{Benefits})\} - 1$
- Example:
  - » Revenue = \$6.0M    Expenses = \$5.5M    P+B = \$2.0M
  - » HC ROI =  $\{[\$6 - (\$5.5 - \$2)] / \$2\} - 1 = (6 - 3.5) / 2 - 1 = 2.5 / 2 - 1 = 1.25 - 1 = .25$  or 25%
  - » For every dollar invested in human capital, operating profit increases by 25 cents for a return of 25%

# *Focus on Key Measures:*

## *Turnover Rate*

- Turnover causes costs such as replacement costs, onboarding costs and workforce separation costs and may impair productivity and quality
- Turnover rate =  
$$\left( \frac{\text{Total number of leavers}}{\text{Average total number of employees}} \right) \times 100$$
- Number of leavers includes voluntary and involuntary separations
- A voluntary turnover rate (without retirement) may also be calculated

# *Focus on Eight Training and Development Measures*



- Five are grouped under Skills and Capabilities
- Two are under Leadership
- One is under Compliance and Ethics
- Of the eight, two are recommended for external reporting by all organizations
  - » Total development and training cost
  - » Percentage of employees who have completed training on compliance and ethics

# *Total Development and Training Cost*



- Called direct expenditure by ATD in the State of Industry report
- Formula: Spending by training departments + training by other departments + tuition assistance
- Basically, all spending on training except
  - » Participant travel cost and opportunity cost
- Benchmarked as average spending per employee, average spending per learner, spending as a % of revenue

# *Other Training and Development Measures*



- Percentage of employees who participate in training
- Percentage of employees who participate in formal training by category
- Percentage of leaders who participate in training
- Percentage of leaders who participate in leadership development
- Average formal training hours per employee
- Workforce competency rate

# *These Changes Will Impact All Organizations*



- Privately held companies, nonprofits, educational institutions, and governments all will be impacted
- Once publicly traded companies begin to disclose, others will be compelled to follow
- Why would someone go to work for a company that will not share its human capital measures?
- Why would an employee stay at such a company?



# *What You Can Do Now to Get Ready*



- Raise the issue in your organization
- Inventory the human capital measures you currently report internally
- Given your business and the guidance from the SEC and ISO, what measures should you start reporting publicly?
  - » From an investor point of view
  - » From an employee point of view

# *What You Can Do Now to Get Ready (continued)*



- How do you believe your organization compares to others on the list of measures you might report?
  - » If not so good, you have one to two years to improve
- Bottom line, you need a human capital reporting strategy, and you need to start developing it now

# *Your Human Capital Reporting Strategy*



- Measures to be reported publicly
- Definitions and formulas for those measures
- Plan for starting to collect measures you don't have today
- Plan to benchmark your measures against others to identify where improvement is needed
- Plans to improve unfavorable measures
- Plans for writing the narrative (create a mock-up today)

# *Starting List for Consideration*

## *By SEC Category*



- Attraction
  - » Time to fill vacant positions
  - » Time to fill critical vacant positions
  - » Percentage of positions filled internally
  - » Percentage of critical positions filled internally

# *Starting List for Consideration*

## *By SEC Category*



- Development
  - » Development and training cost
  - » Percentage of employees who have completed training on compliance and ethics
  - » Also may want to consider
    - Percentage of employees who participate in training
    - Average hours of formal training per employee
    - Percentage of leaders who participate in training
    - Percentage of leaders who participate in leadership development

# *Starting List for Consideration*

## *By SEC Category*



- Retention
  - » Turnover rate
  - » May also want to consider
    - Turnover rate for critical positions

# *Starting List for Consideration*



- Compliance and ethics
  - » Number and type of grievance filed
  - » Number and type of disciplinary action
  - » Percentage of employees who have completed training on compliance and ethics
- Costs
  - » Total workforce costs

# *Starting List for Consideration (cont.)*



- Diversity
  - » Workforce diversity by age
  - » Workforce diversity by gender
  - » Workforce diversity by disability
  - » Workforce diversity by other
  - » Diversity of leadership team
- Leadership
  - » Leadership trust



# *Starting List for Consideration (cont.)*



- Organizational culture
  - Employee engagement (not included in the 23)
- Organizational health, safety, and well being
  - Lost time for injury
  - Number of occupational accidents
  - Number of people killed during work
- Pay equity (not included in 23)

# *Starting List for Consideration*



- Productivity
  - » Revenue or profit per employee
  - » Human capital ROI
- Recruitment, mobility, and turnover
  - » Time to fill vacant positions
  - » Time to fill critical vacant positions
  - » Percentage of position filled internally
  - » Percentage of critical positions filled internally
  - » Turnover rate
  - » Turnover rate for critical positions (not included in 23)

# *Starting List for Consideration (cont.)*



- Skills and capabilities
  - » Total development and training cost
  - » Percentage of employees who participate in training (not incl in 23)
  - » Average formal training hours per employee (not incl in 23)
  - » Percentage of leaders who participate in training (not incl in 23)
  - » Percentage of leaders who participate in leadership development (not incl in 23)
  
- Succession Planning
  - » Successor coverage rate (not included in 23)
    - $\text{Number in leadership successor pool} / \text{Number of leaders}$

# *Starting List for Consideration (cont.)*



- Workforce availability
  - » Number of employees
  - » FTEs
  - » Independent contractors (not included in 23)
  - » Temporary workforce (not included in 23)

# *Conclusion: Change is Coming*



- New SEC rules will profoundly change human capital reporting
  - » Leading to a new age of transparency
- ISO standards a likely starting point for US companies
  - » Some countries will mandate the ISO standards
- So, two initiatives come together to drive irreversible change
- Start to prepare now!

# *Learn More*



- Blog by David Vance at [Chief Learning Officer](#) November 9
- The final SEC rule is available at <https://www.sec.gov/rules/final/2020/33-10825.pdf> The rule is 130 pages, but the section on human capital is under section IIB7 pages 45 -54.
- The ISO document (ISO 30414:2018 Human resource management — Guidelines for internal and external human capital reporting) is available for purchase at <https://www.iso.org/standard/69338.html> for CHF138 (\$140)
- Contact me at [DVance@CenterforTalentReporting.org](mailto:DVance@CenterforTalentReporting.org)