

# Will You Be Ready if the SEC Mandates Human Capital Disclosure?

# What Is Happening?

- The U.S. Securities and Exchange Commission (SEC) published proposed rules on August 8 to mandate human capital disclosure
- Rules should be finalized in early 2020. (Congress does not have to approve)
- Effective date is not known but fiscal year 2021 would be reasonable

# SEC Background

- The SEC was created in 1934 to regulate companies that sell securities to the public
- They require 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

# 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 the financial statements
- Only one of these is related to human capital: number of employees

# Examples of the 12 Items That Must be Disclosed Today

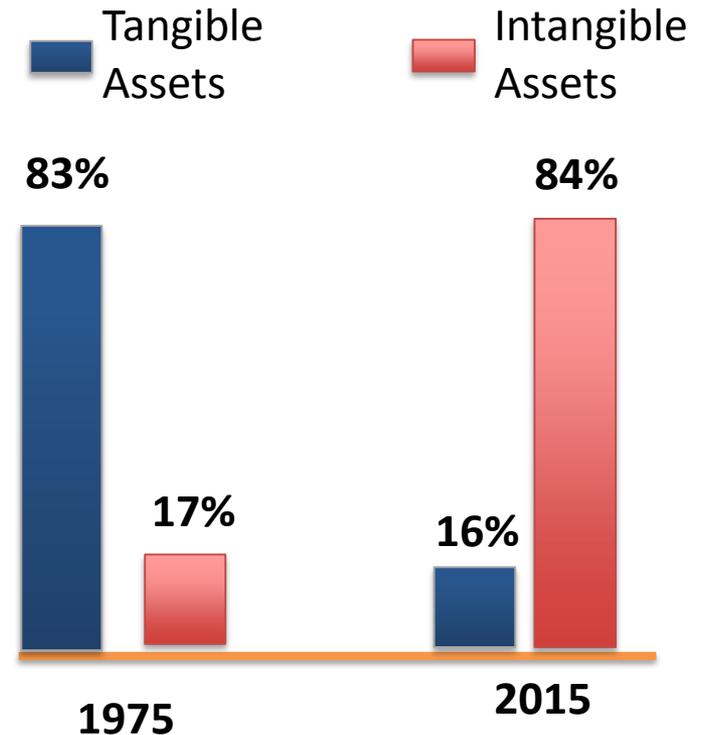
- Principal products and services
- New products and segments
- Competitive conditions
- Seasonality
- Backlog of orders
- Sources and availability of raw materials
- Number of employees

# 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
  - Guidance provided

# The Changing Roles of Physical and Human Capital

- Tangible assets
  - Land, machinery
  - Equipment
- Intangible assets
  - Difference between book value and tangible assets
  - Equals human capital



Source: Ocean Tomo, LLC

# The SEC Proposal for Human Capital Disclosure

- “...replace the current requirement to disclose the number of employees with a requirement to disclose 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 48)

# Key is Materiality

- What human capital measures would an investor be interested in before buying or selling a security?
- What measures tell an investor about the health of the company?
- What major HR initiatives does the company have under way?
- Guidance that the description should include at least a discussion of
  - Attraction, development and retention

# From a Risk Mitigation Perspective

- Their risk is being sued by an investor for failure to disclose material information on human capital – the driving factor today in most company's performance
- Companies likely 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) just published the first Human Capital Reporting standards in December 2018
- 60 measures recommended for internal and external reporting
  - 23 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 Stefanie 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>	<b>Large</b>		<b>Small and Medium</b>	
	<b><u>Organizations</u></b>		<b><u>Organizations</u></b>	
	<b><u>Internal</u></b>	<b><u>External</u></b>	<b><u>Internal</u></b>	<b><u>External</u></b>
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>

# Measures for External Reporting by All Organizations

- Percentage of employees who have completed training on compliance and ethics
- 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

# Additional Measures for External Reporting by Large Organizations

- Workforce diversity by age, gender, disability, other
- Diversity of leadership team
- Leadership trust
- Time to fill vacant positions
- Time to fill critical vacant positions
- Percentage of positions filled internally
- Percentage of critical positions filled internally

# 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
- Draft formula: Spending by training depts. + training by other depts. + tuition assistance
- Basically, all spending on training except
  - Participant travel cost and opportunity cost
- Benchmarked as average cost per employee, average cost per learner, cost as a % or 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 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 Happens Next?

- SEC will finalize rules
  - They may or may not provide examples of human capital measures
  - In any case, the test will be materiality
- ISO Working Group 2 is defining the measures and creating examples
  - For example, 25 pages on the five for skills and capabilities

# 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
  - Form an employee point of view

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

- How do you believe your company compares to others on the list of measures you might report?
  - If not so good, you have one or 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 draft today)

# Starting List of Measures for Consideration

- Turnover rate (retention rate)
  - Turnover rate for critical positions
- Time to fill positions
  - Time to fill critical positions
- Percentage of positions filled internally
  - Percentage of critical positions filled internally

# Starting List of Measures for Consideration

- Workforce diversity by age, gender, disability, other
- Diversity of leadership team
- Total workforce cost
- Number of accidents, Number killed during work
- Number of employees and FTEs

# Starting List of Measures for Consideration (continued)

- Total cost of training and development
- Percentage of employees who have completed training on compliance and ethics
- Percentage of employees who participate in training
  - Percentage of leaders who participate in training
  - Percentage of leaders who participate in leadership development
- Average formal training hours per employee

# Conclusion

## Change is Coming!

- New SEC rules will profoundly change human capital reporting
  - 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!

# Get Involved!

- ISO Technical Committee 260 focuses on human capital
  - International effort with well-defined processes
  - Various working groups
    - WG2 Metrics, WG11 Learning, others
  - <https://www.iso.org/committee/628737.html>
- ANSI (American National Standards Institute) is secretariat for TC260 and sponsors US TAG (Technical Advisory Group): Join this to contribute
  - [https://www.ansi.org/standards\\_activities/standards\\_boards\\_panels/TC260?menuId=31](https://www.ansi.org/standards_activities/standards_boards_panels/TC260?menuId=31)

# For more information

- Blog by David Vance at <https://www.chieflearningofficer.com/2019/10/31/human-capital-disclosure-may-soon-be-mandated-by-the-sec/>
- The proposed SEC rule is available at <https://www.sec.gov/rules/proposed/2019/33-10668.pdf> The rule is 116 pages, but the section on human capital is under section IIB7 pages 44 -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)