New human capital disclosure rules: Getting your company ready

With up to 85% of a company’s costs tied up in people (pwc.com), stakeholders looking to allocate investment dollars want to understand how management sees the company’s strategic and operational requirements. The SEC introduced new disclosure requirements in August 2020 designed to provide stakeholders insight into human capital—from the operating model, to talent planning, learning and innovation, employee experience, and work environment. The disclosures may help stakeholders evaluate whether a business has the right workforce to meet immediate and emerging business challenges and the nature and magnitude of the related investments. However, there are questions as to what is required to comply with the principles-based rules.

In certain SEC filings, a public company is now required to disclose:

• the number of employees and a description of its human capital resources, if material to the business as a whole; and if material to a particular segment, that segment should be identified
• any human capital measures or objectives, if material, that the registrant focuses on in managing its business, such as those related to the development, attraction, safety, engagement, and retention of employees

The rules do not include a definition of “human capital” or a list of required measures to disclose. The principles-based approach (1) reflects an expectation that disclosures will be tailored to a company’s own business or industry using management’s judgment and (2) allows for the disclosures to evolve in response to changes in a company’s environment.

We also are not adopting a definition of the term “human capital” …because this term may evolve over time and may be defined by different companies in ways that are industry specific. This approach is consistent with the view expressed by a number of commenters that noted that there are many definitions of human capital and that the concept, while generally well understood, is often tailored to the circumstances and objectives of individual companies.

– Release on Modernization of Regulation S-K Items 101, 103, and 105

I am particularly supportive of the increased focus on human capital disclosures, which for various industries and companies can be an important driver of long-term value.

Jay Clayton, then SEC Chairman
The new rules, which are part of the SEC’s broader project to modernize Regulation S-K, became effective November 9, 2020. As a result, 2020 Form 10-Ks and other filings subject to Regulation S-K filed on or after this date need to include the new disclosures.

### Scoping

**Step 1**

**Inventory**

all human capital measures or objectives that you focus on in managing the business.

**Step 2**

**Narrow the inventory**

to include the measures that are material to an understanding of the business.

### Reliability and consistency

**Step 3**

**Implement processes and controls**

over the preparation and reporting of human capital measures.

**Step 4**

**Consider subsequent measurement and reporting.**

Human capital measures should be consistent from period to period. Changes to how the measures are used or calculated should be disclosed.

While every company will differ, the following can help guide your approach.

**Scoping**

Companies are evaluating which objectives or measures to disclose to comply with the principles-based requirements and meet investor and regulator expectations. Jay Clayton, then SEC Chairman, noted that he expects to see “meaningful qualitative and quantitative disclosure, including, as appropriate, disclosure of metrics that companies actually use in managing their affairs.” But beyond that general guidance, companies have broad flexibility. Although specific to each company depending on its workforce strategy, we recommend companies consider the following, including a specific focus on two areas that significantly impacted most companies in 2020: COVID-19 and diversity, equity, and inclusion (DEI).

**Human capital resources**

Human capital resources, while not defined in the rules, may include employees, non-employees, such as contract workers, and others.

**Objectives or measures**

The rules require disclosure of human capital objectives or measures used to manage the business if material to an understanding of the business. Companies need to consider whether to include a qualitative objective and/or a quantitative measure in each area of human capital.
Sources of measures

The rules require companies to consider the measures used by management in running the business, which may include those reported in an enterprise balanced scorecard, or board or executive reporting, or considered in executive compensation.

Companies might also consider what aspects of human capital have been previously communicated as being critical to the business, whether in public filings, investor and employee briefings, or other public statements. For example, companies may have included explicit references to their human capital resources in their proxy filings; environmental, social, and corporate governance (ESG) disclosures; as well as during shareholder engagement.

Various resources may also help companies focus on what investors and other stakeholders consider to be meaningful:

- **International Organization for Standardization** recommendations on human capital reporting standards
- **Sustainability Accounting Standards Board** sector-specific human capital metrics
- World Economic Forum report (published with the Big 4 accounting firms) that defines common metrics for sustainable value creation and ESG reporting, which includes human capital
- PwC’s **Saratoga** benchmarking tool that provides industry-specific metrics in various areas of human capital: workforce productivity, span of control, succession, recruiting costs, hire quality, labor costs, turnover, diversity, HR cost, and organizational structures
- Other frameworks, such as those developed by Morgan Stanley Capital International (MSCI) or Institutional Shareholder Services (ISS)

Lastly, companies might consider whether peer disclosures create an expectation for comparable disclosures.

Material to the business

The requirements are rooted in materiality. The SEC considers information material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment or voting decision. This may be an appropriate benchmark in identifying which human capital measures or objectives are material to the business.

Focusing human capital disclosures in light of current events

As the rule indicates, human capital disclosures should evolve over time as companies respond to risks and challenges. There are perhaps no better examples of risks and challenges a company needs to address than the COVID-19 global pandemic and the need for diversity, equity, and inclusion. In this first year of adoption, we suggest focusing human capital disclosures in these areas if material to the business.
COVID-19

The COVID-19 crisis spotlighted the importance of having policies that protect employees and invest in their well-being. For months, companies have grappled with how to adapt their human capital management to retain their workforce, provide a safe workplace, accommodate remote workers, and respond to difficulties in supply chains. Areas of a company’s human capital management that might be impacted by COVID-19 include the following.

COVID-19 and the impact on human capital

<table>
<thead>
<tr>
<th>Well being</th>
<th>Mental health</th>
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<tbody>
<tr>
<td>Recognizing the toll remote work and other challenges can take on their employees, many companies are implementing various programs or initiatives to invest in their employees’ well being.</td>
<td>Health and safety of employees, especially in essential services, has become a top priority for companies.</td>
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<table>
<thead>
<tr>
<th>Succession planning</th>
<th>Onboarding</th>
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<tbody>
<tr>
<td>Some companies are seeing increased focus by their Boards and stakeholders on key roles beyond the C-suite and future plans for those roles.</td>
<td>Onboarding new employees while much of the workforce is working remotely has posed significant challenges, often requiring companies to digitally upskill their employees.</td>
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<tr>
<th>Furloughs/ Lay offs</th>
<th>Compensation</th>
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<td>Some companies especially hard hit by the pandemic have had to either temporarily or permanently let go of some of their workforce.</td>
<td>Many companies have had to change compensation or pay structure for employees and/or management in response to declines in business or profitability.</td>
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</table>

Diversity, equity, and inclusion

DEI has become not only an area of public policy, but also an issue of corporate responsibility. Stakeholders want to know how companies are creating an equitable workplace, and how they plan to respond to other DEI matters, including ensuring diversity at the management and board levels. DEI measures or objectives to consider that might be material to a company’s business include the following:

- Diversity measures related to employee identities, such as race and ethnicity, gender identity and expression, sexual orientation, culture, veteran status, age, disability, marital status, or religious and spiritual beliefs
- Equity measures related to providing employees equal access to opportunities, such as equity in pay, the percentage of a company’s management team that is diverse, or recruiting strategies aimed at providing fair opportunities for diverse talent
- Inclusion efforts, such as networks or programs that connect employees so they can support one another and advise company leadership on the needs of diverse employees

Metrics alone may not tell the full story of a company’s values, the scope of its DEI programs, or the true investment it has made in its employees. A thorough narrative that is linked to a company’s corporate purpose and mission can help bridge this gap.
Reliability and consistency

The new human capital disclosures should be supported by effective controls and procedures. For example, when included in the annual report, they will be subject to the company’s disclosure controls and procedures (DCP), but when included in other filings, such as registration statements, separate controls may be needed. As your company considers the appropriate controls over these new disclosures, questions could include:

- What is the quality of the data underlying the disclosures?
- What governance exists over this data? Does it flow through the disclosure committee, board of directors, and/or audit committee?
- Based on the type of filing, are the disclosures subject to DCP or are there other processes and controls that support the reliability of the information reported?
- Do we have a policy on scoping, measurement, and presentation of the information to aid consistency between periods?
- Will consumers of the human capital information be confident in its accuracy and completeness?
- Do we have a process for determining when changes to measures are needed and disclosed?

Follow the data

Quality data is foundational to disclosures. Companies may face challenges in obtaining, analyzing, and reporting on the data, including the following.

<table>
<thead>
<tr>
<th>Key challenges</th>
<th>Where to start</th>
</tr>
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<tbody>
<tr>
<td>Applicable framework and key metrics</td>
<td>• No requirements for specific metrics—companies have to decide what is material and most applicable</td>
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<tr>
<td></td>
<td>• Define a set of relevant metrics and proactively identify what information to report, how to source it, and who the key stakeholders are</td>
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<td></td>
<td>• What is “material to the business” changes from period to period, but the principles surrounding the evaluation should remain the same</td>
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<tr>
<td></td>
<td>• Establish processes for revisiting key metrics each period</td>
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<tr>
<td>Data sources and transformation</td>
<td>• Data comes from various financial and nonfinancial systems</td>
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<tr>
<td></td>
<td>• Identify standardized data sources/attributes</td>
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<td></td>
<td>• Manual intervention is often required</td>
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<td></td>
<td>• Historical data may not be available</td>
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<tr>
<td>Process and governance</td>
<td>• Limited controls or attestations over the data</td>
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<tr>
<td></td>
<td>• Establish clear processes, controls, and attestations appropriate for each disclosure (e.g., DCP for disclosures in the annual report)</td>
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<tr>
<td></td>
<td>• Limited governance - data was not reviewed by the disclosure committee, board of directors, and/or audit committee</td>
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<td></td>
<td>• Establish governance protocols, including ensuring key information is shared with the disclosure committee and the audit committee</td>
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<tr>
<td>Reporting and analytics</td>
<td>• No standardized reporting process</td>
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<tr>
<td></td>
<td>• Expand existing reporting frameworks to include this data when applicable</td>
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<td></td>
<td>• Data consolidation may be manual and may not always lend itself to actionable insights</td>
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<tr>
<td></td>
<td>• Increase communication and collaboration between human resource and finance personnel to proactively drive actionable insights</td>
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<tr>
<td></td>
<td>• Limited self service analytics tools</td>
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<tr>
<td></td>
<td>• Use data analysis and visualization tools to automate reporting and analysis</td>
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</table>
What have filers disclosed?

We looked at more than 2,000 Form 10-Ks filed from November 9, 2020, the effective date of the new rules, through February 28, 2021. In these Form 10-Ks, we noted:

- 89% included both qualitative and quantitative metrics
- 75% included disclosures related to COVID-19 and the impact to human capital, the majority of which were qualitative
- 66% disclosed DEI information (e.g., gender, sexual orientation, ethnicity, veteran status, culture, strategy, age, religion), much of which was qualitative; many companies did not include measures or objectives related to diversity at the management level, and the quantitative DEI metrics disclosed primarily included the total number of employees and gender percentages
- Other trends include:

Percent of 10-K filings that include*:

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
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<tbody>
<tr>
<td>Employee demographics</td>
<td>99%</td>
</tr>
<tr>
<td>Employee lifecycle</td>
<td>73%</td>
</tr>
<tr>
<td>Safety</td>
<td>62%</td>
</tr>
<tr>
<td>Total rewards</td>
<td>61%</td>
</tr>
<tr>
<td>Labor relations</td>
<td>47%</td>
</tr>
<tr>
<td>Employee feedback</td>
<td>32%</td>
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*Includes both quantitative and qualitative disclosures

The future of human capital reporting

The change of administration in the White House and the SEC could influence the focus on human capital disclosures. Two SEC Commissioners dissented to the final rule and pushed the Commission to play a more active role in enhancing reporting for topics such as ESG, including climate change.

Amid these broader unknowns, a company should make sure it accurately and thoroughly describes the impacts on human capital of current events, COVID-19 and the focus on DEI in particular, if material. In addition, it should periodically assess whether the human capital measures disclosed continue to be the most relevant. Appropriate controls and processes will need to be maintained, especially when it comes to the underlying data supporting human capital disclosures.

Effective and transparent disclosure of human capital initiatives will provide stakeholders with a new window into how a company manages its workforce and invests in its people to create long-term value.
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