New human capital disclosure rules: Getting your company ready

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, SEC Chairman

What is changing

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 recently introduced new disclosure requirements 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 principle-based rules.

Taking a closer look

In certain SEC filings, a public company will be 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 reflects an expectation that disclosures will be tailored to a company’s own business or industry using management’s judgment and that they may evolve over time.

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.

– Final Rule: Modernization of Regulation S-K Items 101, 103, and 105

The new rules, which are part of the SEC’s broader project to modernize Regulation S-K, become effective November 9, 2020. As a result, 2020 Form 10-Ks filed on or after this date will need to include the new disclosures.
Getting started
While every company will differ, these steps 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. SEC Chairman Jay Clayton noted that he “expect[s] 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. What should companies include?

**Human capital resources**
Human capital resources, while not defined, 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**
Companies are required 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 measures

- 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.
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 ensuring that they are disclosed?

The future of human capital reporting

Companies will need to periodically assess whether the human capital measures disclosed continue to be the most relevant for managing the business, update them when needed, and maintain the appropriate controls and processes. Effective and transparent disclosure of human capital initiatives will provide stakeholders with a new window into how a company manages its workforce.

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