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First Look at the Human Capital Disclosures on Form 10-K - The CPA Journal

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In Brief

The SEC recently required registrants to disclose information on human capital resources that is material to understanding a company's business. Although this represents a step forward for sustainability reporting, the current guidance is unclear, leading stakeholders to wonder about its practical value. The author analyzed the first round of required disclosures to discern whether they will be useful to the users of 10-K reports.

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Human capital is defined as "the skills, knowledge, and qualifications of a person, group, or workforce considered as economic assets" (Merriam-Webster.com). Public companies in several countries include disclosures of their human capital either by choice or because they are required to do so. Yet in the United States, until August 2020, Item 101(c)(1)(xiii) of Regulation S-K required listed companies to disclose only the number of employees for the year of Form 10-K. Although some companies disclosed a little more information about their work-force under "Item 1. Business" in Form 10-K, such information often varied from company to company. Some companies disclosed the breakdown of the workforce by location or function and others gave information about the benefits offered to their employees. Several companies' disclosures ended with boilerplate language assuring readers that the company's relations with its employees were "satisfactory" or "good." There was no consistency in the type or amount of information disclosed.

Recently, the SEC amended Item 101(c) of Regulation S-K to require its registrants to include a disclosure of their human capital resources in Form 10-K, effective November 9, 2020, if such disclosure is material to understanding the listed company's business taken as a whole (Final Rule: Modernization of Regulation S-K Items 101, 103, and 105, https://bit.ly/2U6F8ND). The SEC, in its final Release 33-10825, has not provided definite parameters as to the nature of the disclosure, because it is new and is expected to vary among the registrants based on their respective industries. Furthermore, stakeholders would probably want to know different kinds of details depending on the type of business and the nature of a company's social, political, and regulatory environment. Although the SEC does not define the term "human capital," it still requires reporting companies to include in its disclosure any human capital measure that is "material to an understanding of the registrant's business" in the spirit of a principles-based approach.

The author examined the first round of the human capital disclosures made by some of the largest listed companies in the United States in their Form 10-K reports filed after the SEC rule went into effect. A review of these 10-K disclosures provides some initial insight into the level of details disclosed in the first year of compliance, the comparability of the disclosures across companies, and the kind of metrics, if any, that are being used. The results indicate a wide variety in the human capital disclosures of the different companies in the sample, as was expected in the absence of an SEC-mandated framework on this topic. The author also compared the current Form 10-K disclosures with the relevant human capital-related topics in the standards published by the Sustainability Accounting Standards Board (SASB) in the United States and under the Non-Financial Reporting Directive (NFRD) or Directive 2014/95/EU of the European Commission. A noticeable variation was found between the disclosures in Form 10-Ks and the best practices from the SASB standards as well as the NFRD guidelines, which was expected because neither framework is binding on the companies listed with the SEC.

The SEC's Human Capital Disclosure Requirement

Until the SEC rule regarding the disclosure of human capital was released in August 2020, it was not a common practice to include in Form 10-K any information about how a listed company managed its workforce that contributed to its revenue-earning capacity; typically, companies included such information in their corporate responsibility reports. The term "human capital" was not in vogue and was not clearly defined by the regulatory bodies. The proxy statement annually filed by a listed company with the SEC (also referred to as Form DEF 14A) included limited information about what the board of directors' priorities were in the areas of attracting, developing and retaining employees, ensuring diversity and inclusion, and protecting employees' safety. The focus of much of the disclosure in the proxy statement was on how the board handled leadership development, succession planning, and management compensation, with very little emphasis placed on nonmanagerial human resources.

With the SEC amendment to Item 101(c) of Regulation S-K, listed companies are now required, "to the extent such disclosure is material to an understanding of the registrant's business taken as a whole, a description of a registrant's human capital resources, including any human capital measures or objectives that the registrant focuses on in managing the business" (SEC 2020, Human Capital Disclosure, Final Amendment). Although the SEC identified the issues of attracting, developing, and retaining employees as examples of subjects considered important to readers, it did not mandate the disclosure of these matters; instead, it recommended that each company disclose such details as are specific to its own business and circumstances.

Survey

The SEC rule regarding the human capital disclosure went into effect on November 9, 2020. Therefore, a sample was selected from the top 100 largest U.S. companies included in the *Fortune* 500 list of 2020 that had actually filed their most recent Form 10-K after November 9, 2020, and by March 31, 2021. The companies were listed on either the New York Stock Exchange (NYSE) or Nasdaq. In each case, the disclosure was read from "Item 1-Business" on Form 10-K and examined for its contents. Given the size of each company in the sample and their scale of operations, as well as the reach that some of these companies enjoy across the global markets for human resources, the survey expected to find "exemplary disclosures" of human capital.

Findings

Of the 100 companies included in the sample, 97 presented the information under a separate sub-heading under Item 1 of Form 10-K, often titled "Human Capital" or "Human Capital Management." A few companies used more familiar titles such as "Our People" or "Our Colleagues." However, three very large companies that belonged to different industries provided noticeably short disclosures without the use of any subheading, either excluding much of the information disclosed by the majority of the sampled companies or mentioning it very briefly. For most companies, the disclosure began with an opening paragraph that summarized the company's commitment to its employees and often included a brief commentary about the company's culture of treating its employees with respect, its mission of caring about the general well-being of its employees, and its overall policy and strategy towards maintaining its workforce before disclosing in detail the various aspects of its human capital management.

Although the SEC does not define the term "human capital," it still requires reporting companies to include in its disclosure any human capital measure that is "material to an understanding of the registrant's business" in the spirit of a principles-based approach.

All but two companies provided either the actual or approximate number of employees as of the balance sheet date under the human capital subheading of Item 1 on Form 10-K. The other two companies provided this required metric under another subheading, "Overview of Business and Strategy," or in a different section such as "Item 6–Selected Financial Data." Several companies also mentioned the number of new hires during the financial year, while a few provided details on how many employees left either voluntarily or otherwise. Half of the companies indicated the number of employees located in the United States, and 20% gave the breakdown of full-time and part-time employees. In general, a review of the disclosures identified the following themes related to human capital management, as shown in *Exhibit 1*.

Exhibit 1

Themes Observed in the Human Capital Disclosures in Form 10-K

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Theme	Companies disclosing	Typical details provided in disclosures	Examples of metrics disclosed
Diversity and inclusion data	95%	Provided a description of the approach to achieving diversity and inclusion among their workforce. A few companies only mentioned diversity and inclusion in one sentence, while many companies described their efforts in detail and some also mentioned relevant statistics or metrics. Some companies only mentioned future targets.	Number of workers covered by implicit bias training, diversity on the board of directors and senior executives, gender diversity in the recruitment activities.
Attraction and recruitment efforts	28%	Just mentioned in a sentence, or described very briefly or reasonably, efforts undertaken to attract and recruit employees. Information included efforts that companies made annually to find and hire employees by interacting with colleges and universities and offering internships.	Number of participants in virtual internship programs, amount paid in tuition reimbursement.
Training and development of employees, and retention	75%	Described either briefly or in detail initiatives adopted to enhance the skillset and support the career development of employees to both retain them and help them perform better. Some companies included one or more metrics as a part of their disclosure, such as the dollar amount spent supporting college expenses of employees (Disney) or the number of training hours spent in employee development (Dollar General Stores).	Voluntary employee turnover, number of employees participating in leadership training, percentage of positions filled internally, number of training courses offered to all employees, number of training courses actually completed, average length of service for all employees.
Workplace safety measures	37%	Described efforts in ensuring the workplace safety of workers and other employees. Descriptions varied from just a one-liner to several lines. A few companies mentioned the metrics that they used but did not provide their values, while some companies gave detailed metrics with values regarding employee safety.	Incident rate, number of years without employee fatality, percentage of company sites without recordable injuries or without lost workday injuries, injury frequency rate.
COVID-19 relief	65%	Disclosed COVID-19 relief efforts in just one sentence, as a brief disclosure, or as a detailed description of measures taken to help employees and protect their health and safety. This item was not as widespread among the disclosures of the sampled companies as was expected.	Number of employees able to work from home, amount committed to ensure safe operations during the pandemic, amount of monetary assistance to employees whose families lost income.
Financial benefits and rewards, and other forms of recognition	80%	Discussed matters such as competitive pay, various insurance benefits, retirement plans, vacation policies, and childcare benefits. A few companies described how they were trying to achieve pay parity between men and women as well as white and nonwhite employees (e.g., Altria) or were recognizing the good work of their employees (e.g., American Airlines).	Minimum hourly wage rate, pay parity across race and ethnicities, pay equity across genders, median annual compensation paid to all employees, number of times employees were recognized.
Employee engagement	57%	Described how they facilitated employees' engagement within the company, whether in the context of diversity and inclusion or with the objective of promoting loyalty and retention, or within the community in which the business operates. This was accomplished through holding small discussion sessions, town hall meetings or conducting employee surveys (e.g., Macy's). Some companies also gave matching gifts to charity and offered paid leave for volunteering (e.g., Fannie Mae).	Employee engagement index, percentage of employees who participated in the engagement survey, amounts matched by the company with the charitable gifts given by the employees, number of hours of paid leave allowed to employees for volunteer work.

Several companies discussed how they worked to promote the healthy lifestyle and general well-being of their employees under a separate subheading within the human capital disclosure and recognized that a healthy workforce was essential to maintain employee productivity and ensure safety in the workplace. The discussion included efforts to provide both physical and mental health support to employees. Information about employees' health and wellness was often combined with a description of either the financial compensation or the safety of employees, which made it difficult to quantify its occurrence within the overall disclosures.

Comparison with SASB's Human Capital–Related Topics

SASB is a private sector entity that promulgates standards for disclosing financially material information about how companies in different industries manage their environmental, social, and governance responsibilities. SASB's standards are not enforceable in the context of the human capital disclosures in Form 10-K because companies are not *required* to adhere to those standards in SEC filings. The SASB Standards identify the following four human capital–related topics: 1) labor practices; 2) employee health and safety; 3) employee engagement, diversity and inclusion; and 4) supply chain management. Under each topic, several metrics are "most likely to have material financial impacts on the typical company in a given industry" (SASB Human Capital Bulletin, Nov. 21, 2020, https://bit.ly/3jS5PhS). Examples include: the percentage of active workforce covered under the collective bargaining agreements, turnover rate, average hourly wage and percentage of employees earning minimum wage, and number of accidents and incidents while at work. The author compared the disclosures of human capital management in the sample 10-Ks with the relevant topics under the SASB standards (see *Exhibit 2*).

Exhibit 2

Human Capital Disclosures in Form 10-Ks Compared with SASB Standards

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Topic under SASB Standards	Actual Disclosure in Form 10-Ks in the Sample
Labor Practices	All companies with labor unions disclosed the fact that their employees were covered under one or more unions, in the United States or other countries, as applicable, and most companies disclosed either the number or the percentage of employees governed by the collective bargaining agreements. One company (Archer Daniels Midland) stood out in terms of its disclosure of the number of employees by contractual relationship and worldwide locations. A few companies also disclosed the voluntary attrition rate. However, most companies did not disclose majority of the metrics recommended by SASB.
Employee Health and Safety	Less than half of the sampled companies disclosed the measures they took to maintain the health and safety of their employees. Furthermore, only four companies (ADM, Caterpillar, Duke Energy, and Valero Energy) disclosed the use of one or more safety metrics, the most common being "incident rate," which is related to one of the safety metrics recommended by SASB. However, the majority (65%) of the sampled companies described how they were handling the welfare of their employees since the onset of the COVID-19 pandemic, in keeping with the "health & safety" topic under SASB, although many companies did not disclose any metrics with respect to their handling of the pandemic.
Employee Engagement, Diversity, and Inclusion	Most of the companies in the sample disclosed their efforts with respect to promoting employees' engagement within the company and the community, with 95% discussing how they worked to increase diversity and inclusion in the workforce, both of which are identified specifically under the SASB Standards. Yet only two companies disclosed any metric under engagement, with five disclosing metrics under diversity and inclusion, with one more company promising to disclose metrics in the future. In addition, less than half of the sample provided the gender-based or race/ethnicity-based breakdown of their workforces, which is one of the recommended metrics under the SASB Standards.
Supply Chain Management	SASB recognizes the "risks associated with suppliers over which the reporting entity has some degree of control", and accordingly it recommends four different metrics related to social and environmental issues associated with a company's supply chain. At the present time, very few of the sampled companies (e.g., Altria) disclose how they are dealing with the human capital impact of their supply chain.

Most importantly, the SASB Standards recommend a metric titled "Total amount of monetary losses as a result of legal proceedings" under each of the first three topics above, which was not disclosed by any of the sampled companies. Thus, it appears that most of the recommended metrics under the SASB Standards are not being disclosed by the listed companies at the present time, possibly due to the sensitive nature of the information that the companies are not ready to share with the outside world unless mandated by the SEC. It is also possible that companies are following these metrics internally and publishing some or all of them in the corporate social responsibility reports, which is not the focus of this study.

Comparison with the EU's Directive on Nonfinancial Reporting

European Union (EU) law requires large public companies to disclose certain nonfinancial information under the rules of Directive 2014/95/EU. (See *Commission Guidelines on Non-Financial Reporting*, EUR-Lex, https://bit.ly/37FmUpA.) The European Commission presents nonbinding guidelines that are intended to help their companies disclose "relevant, useful and comparable nonfinancial information" including information regarding their "employee matters." Specifically, companies are expected to make disclosures about themes such as 1) diversity issues, not just limited to age and gender but also to include other aspects of diversity such as sexual orientation, religion, and disability; 2) employment and working conditions; 3) trade union relationships; 4) remuneration system; 5) training and career management of employees; and 6) health and safety of employees. The guidelines also give examples of key performance indicators (KPI) for each of the above categories of disclosure. Companies are expected to provide such KPIs as are necessary to understand the impact of their business activities and to be consistent with the metrics that are used internally by management. These KPIs are to be used consistently from year to year in order to facilitate comparisons over time. Companies can use either the EU-based framework or any established international framework to make their nonfinancial disclosures.

There are many U.S. companies that operate in Europe and hence have to comply with EU nonfinancial reporting requirements. Further, many of these companies are already publishing annual sustainability reports that discuss in detail how they take care of their employees in terms of safety and health, diversity and inclusion, and talent management. These companies disclose several metrics in their sustainability reports to support their description of the employee-related matters, some or all of which also can be incorporated into the Item 1 disclosure in Form 10-K. When reviewing the human capital disclosures of these U.S. companies, however, the author found that much of the relevant information, including the metrics or KPIs, is missing from the Form 10-K disclosures of many large international U.S. companies. Several of the themes regarding employee matters that are expected under the EU Directive are also found in the human capital disclosures within many U.S. companies' Form 10-Ks; but in the absence of an SEC-mandated framework, there is at present no comparability in the amount and type of information disclosed.

Analysis

When the SEC adopted the amendment to Item 101(c) of Regulation S-K to require listed companies to provide a disclosure of their human capital, it was for the purpose of enabling users to understand how a company was managing its human resources in conducting its business, albeit within the context of its specific industry and unique circumstances. Although the SEC rule identified attraction, development, and retention of employees as subjects of interest, the list was not meant to be exhaustive. Recognizing the inherent differences among the different listed companies based on their industry characteristics and unique features, the SEC decided against a prescriptive approach of requiring specific details in the human capital disclosure. Instead, it expected the companies to disclose information that was "material to an understanding of [their] business."

Given the absence of a clear definition of human capital or a designated list of details that must be provided, the sample analyzed here showed a considerable variety in the content and volume of information that companies are disclosing about their human capital. Because there was no minimum expected level of disclosure, companies chose what to disclose perhaps based on their judgment of the materiality of the information. For example, some companies reported the number of employees located in the United States whereas others reported the number of employees located in North America. In addition, not all companies that hired part-time workers reported the number of such employees, and several companies reported only the "full-time equivalent" number of employees without separating the two categories.

The descriptions of the measures taken to attract and retain employees were sometimes blended with the discussion of the efforts to adequately train and develop, compensate, and engage employees, thus making it difficult to compare across different companies. Although some companies provided quantitative details of the amount of money spent on different initiatives under these areas, others simply mentioned the topic in just one or a few sentences. Nevertheless, some positive pieces of information were revealed in the disclosures: First, a significant percentage of the sampled companies are spending time and money on the professional growth of their employees. While this effort benefits the companies by improving the performance of their employees, it also helps employees grow and thus ensure a steady source of qualified management successors. Second, a large percentage of companies provides opportunities for their employees to engage both within the company and in the external community, and periodically assesses their employees' satisfaction with their work environment and their bonding with fellow employees. Both of these initiatives can have a positive impact on an employer's ability to retain employees for a long period, can help them excel in their workplace performance, and can ensure their physical and psychological welfare. In addition, a large majority of the companies disclosed how they were taking care of the financial well-being of their workforces, an important factor because financial incentives can matter in both attracting and retaining employees.

Finally, although not many companies discussed their efforts to protect the workplace safety of their employees while in the workplace, the topic of adequately responding to the coronavirus (COVID-19) pandemic was important to a large percentage of the companies in the sample, which described, sometimes in great detail, all the measures that they took to protect the physical and mental well-being of their employees. This is important because providing COVID-related relief was necessary for protecting the health of the workforce and ensuring the continuity of the company's operations.

By mandating disclosures of human capital, the SEC has shown that it recognizes the importance of employees at all levels of a business enterprise.

One important limitation of the disclosures analyzed concerns 70% of companies reporting hardly any metrics in their human capital disclosures. Although the SEC rule does not mandate the disclosure of any metrics other than the number of employees, it is difficult to judge the rigor of the initiatives adopted by different companies and their year-over-year progress without metrics. Though some companies reported a few metrics, there was no consistency regarding which were reported. If information were presented with different metrics or key performance indicators that could be compared from year to year, it could become truly useful for understanding the company as a whole. The human capital disclosures of any companies that were to present such metrics could become a model for those companies that provide none at the present time. Companies do not have to invent the metrics for disclosing in Item 1; many of the metrics are already being reported in many companies' corporate social responsibility reports or sustainability reports. Furthermore, the SASB Standards, the EU Directive Guidelines, and the Global Reporting Initiative Standards can provide useful and relevant guidance in this regard.

By mandating disclosures of human capital, the SEC has shown that it recognizes the importance of employees at all levels of a business enterprise and encourages management to disclose about what the company is doing to effectively "manage" this vital resource. The current analysis of the first batch of required human capital disclosures reveals that, although most companies are presenting some information under this subheading, the information is currently scattered in different places throughout Form 10-K, including Item 1A-Risk Factors and Item 6-Selected Financial Data, as well as included in a sustainability report. It is possible that a framework of which information must be reported and which metrics should be provided as a part of the human capital disclosure may evolve over time—either through pressure from financial statement users or via subsequent SEC guidance. Until then, investors will have to continue to glean such information from a variety of disparate, sometimes incomparable sources.

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