Heads Up | Volume 27, Issue 24
November 3, 2020

In This Issue

#DeloitteESGNow — Human Capital Measures Up

by Leeann Arthur, Jenny Lynch, Christine Robinson, Kristen Sullivan, and Maureen Bujno, Deloitte & Touche LLP; and Tara Tays, Jason Flynn, and Edward Sim, Deloitte Consulting LLP

Introduction

Over the past several years, the focus on human capital management under the broader environmental, social, and governance (ESG) umbrella has steadily increased. The concept of the social enterprise — an organization whose mission combines revenue growth and profit-making with the need to respect and support its environment and stakeholder network — has grown from an intriguing new idea into a concrete business reality and marketplace expectation. In 2017, the Human Capital Management Coalition, a group of institutional investors with $2.8 trillion in assets under management, petitioned the SEC for rulemaking to require disclosure of nine categories of information on human capital management policies, practices, and performance. Accelerated by focus on corporate purpose and ESG from groups like the Business Roundtable and influential investors such as BlackRock and State Street Global Advisors, human-capital-related disclosures have been pushed to the forefront of discussion.

The COVID-19 global pandemic and rising social justice movement have further advanced conversations about corporate purpose, ESG performance, and, ultimately, human capital. In particular, these actions spotlight the dependency of companies on their workforce and give them an opportunity to demonstrate how investing in human capital management drives value as a result of engagement, innovation, and productivity. Viewed by investors as material to a company's ability to create long-term value and execute strategy, an understanding of the ways in which an organization perceives and manages its human capital can be essential to evaluating the company's risk profile. In its recently released quarterly stewardship report, the BlackRock Investment Stewardship team disclosed that its shareholder engagement efforts that focused on human capital management issues increased 188 percent over the past year.

This *Heads Up* discusses the growing market movement toward enhanced human capital management disclosure, both as a result of the SEC's final rule that amended and modernized Regulation S-K and of gathering momentum in the marketplace toward more standardized and relevant ESG disclosures, including human capital metrics. The *Heads Up* also provides considerations related to identifying and evaluating human capital disclosures in light of the amendments to Regulation S-K.

Evolution of Human Capital Management Disclosures

Against the backdrop of rising stakeholder capitalism and as part of an ongoing initiative by the SEC's Division of Corporation Finance to improve the effectiveness of disclosure requirements for both investors and companies, the modernization of Regulation S-K marks the first significant update to these disclosure requirements in 30 years. The amendments, which are effective November 9, 2020, significantly update the description of business under in Item 101. While companies will still be required to disclose the number of their employees, they must also specify "any human capital measures or objectives that the company focuses on in managing the business, to the extent material to an understanding of the registrant's business taken as a whole." The SEC acknowledged in the final rule that disclosures may vary from industry to industry and from company to company and that it therefore chose to not explicitly adopt a definition for the term "human capital"; rather, it expects the meaning of the term to evolve over time.

Disclosures should be tailored to a company's particular business, workforce, facts, and circumstances. The amendments establish a principles-based approach to disclosure and provide a means by which organizations can describe their commitment to, and measurable actions associated with, the human capital aspects of their value creation model. As expectations of investors, customers, employees (current and prospective), governments, and other stakeholders increase, these disclosures may be viewed as an increasingly important indicator of an organization's long-term performance and success.

In the final rule, the SEC noted that in feedback on the proposed amendments, numerous commenters supported the use of specified metrics or certain standards or frameworks for providing human capital disclosure. Chairman Jay Clayton addressed this topic at an open meeting of the SEC, indicating that in this initial increase in regulatory emphasis on human capital considerations, the SEC would not attempt to prescribe specific or rigid metrics. However, he emphasized that while the requirements are principles-based, he expects to see "meaningful qualitative and quantitative disclosures" as well as the actual metrics companies use to manage their business.

Resources for Identifying Human Capital Disclosures

Many companies already disclose human capital measures in some form and format; however, such information may exist in disparate places and may not be subject to the same controls and procedures that are used for financial reporting. Companies may also internally track certain metrics that are used for making key decisions but currently excluded from external reporting. At present, human-capital-related disclosures in companies' Forms 10-K are of varying degrees of robustness. Such disclosures include information ranging from the number of employees (as required before the final rule) to details such as full-time or part-time status, racial and ethnic diversity of the workforce, employee retention programs, and worker safety and training programs. Creating an inventory of current and future metrics, whether publicly disclosed or not, can be an efficient starting point in understanding what a company may wish to include in the financial filings. Companies may also review any public statements or commitments made by senior management to understand the types of information investors and other constituents could expect to see disclosed. To create such an inventory as well as to select the appropriate metrics and maintain the integrity and consistency of the data, multiple internal functions will most likely need to coordinate their activities, including human resources, environmental, health and safety, and finance functions.

To demonstrate the value and effectiveness of investments in human capital, companies should inventory and prioritize measures of human capital management through a materiality lens by, for example, measuring how diversity and inclusion lead to an enhanced ability to attract talent and drive strategy; how health, safety, and wellness improve productivity; and how training enhance innovation and speed to market. Regardless of how companies describe their material human capital management measures, the definitions and metrics they use should remain constant from period to period. Disclosures might include metrics that are (1) reported internally to senior management and to the board of directors, (2) used for performance evaluation, or (3) used in determining compensation. For example, they may consider the following metrics:

Theme	Metrics for Consideration
Governance and culture	• Workforce and workplace goals and objectives • Role of executives and board in tracking goals and objectives — tone at the top • Internal and external brand and culture • Employee engagement and empowerment • Major initiatives being undertaken that affect workforce • Awards and accolades
Diversity, equity, and inclusion	• Gender and racial or ethnic group representation • Pay and career equity • Offshore and foreign-national employees • Antidiscrimination policy
Labor practices and policies	• Work time and pay practices • Labor law violations • Risk management • Collective bargaining • Work stoppages • Workplace harassment • Independent contractor management • Health and safety management systems • Incident rates, near misses, fatalities • Occupational health • Emergency response preparedness • Operational and safety-related training
Recruiting, training, development, and retention	• Workforce size and succession planning • Segmentation (union or nonunion, full-time or part-time, geography) • Off-balance-sheet or alternative workforce (contractors, gig workers, etc.) • Talent recruitment, retention, and turnover • Training costs, hours, programs offered • Internal promotion rate • Reskilling and upskilling efforts
Rewards	• Costs (compensation and benefits) and productivity • Health and wellness benefits • Paid family and medical leave • Financial literacy • Educational reimbursements • Work-life balance

Numerous companies apply recognized ESG standards when disclosing human capital measures in their sustainability or ESG reports. To meet the requirements of Regulation S-K, registrants may also consider using these standards to help them identify relevant disclosure metrics. There is increasing market movement toward embracing ESG reporting standards and subjecting the disclosures to more formal controls and procedures. Use of these or other recognized reporting frameworks as a starting point for identifying material human capital metrics for disclosure is a major step forward in providing the capital markets with consistent, relevant information. Recognized standards include those from the following organizations:

- The Sustainability Accounting Standards Board (SASB), whose materiality map identifies and compares disclosure topics, including human capital in different industries and sectors.
- The International Business Council (IBC) of the World Economic Forum (WEF), which is facilitated by the Big Four firms. The WEF's IBC published a report in September 2020 identifying core metrics and disclosures for four "pillars" (i.e., Governance, People, Planet, and Prosperity). Core human-capital-related metrics and disclosures are included under the "People" pillar. This organization's efforts represent an enormous step toward achieving internationally recognized ESG standards as well as a comprehensive and coherent reporting system.
- The Global Reporting Initiative, which has created a set of global standards for sustainability reporting and includes guidance on various human capital management topics such as diversity, equal opportunity, and occupational health and safety, to name a few.

Credible and Reliable Human Capital Management Disclosure

Human capital management disclosures in a company's financial filings should be subject to robust disclosure controls and procedures. As part of its oversight responsibilities, a board of directors should consider the roles of the compensation committee, nominating or governance committee, and others involved in overseeing human capital measures and familiarize itself with the metrics to be included in the financial filings. The audit committee should be involved in understanding whether there are appropriate disclosure and internal control procedures associated with such metrics. In addition, since the market may use human capital disclosures in investment decisions, audit committees should oversee external assurance, which can play an important role in signaling the quality of the information to the market and give decision makers more confidence in the quality and reliability of human capital and ESG information in general. Statistics indicate, however, that only 29 percent of S&P reporting companies obtained external assurance on their sustainability or ESG reports as of 2019, and of those companies, not all included human capital metrics within the scope of assurance.

Conclusion

To comply with the new SEC requirements related to human capital, registrants will need to carefully consider the themes discussed above and assess which disclosures or metrics would be meaningful to stakeholders. We believe that enhanced human capital management disclosure offers companies an opportunity to positively support a broader narrative on the company's purpose. Investors and other key stakeholders are likely to continue to seek more consistent and comparable metrics. Consequently, companies that are able to clearly communicate the material human capital measures and objectives that management focuses on may reap benefits when interacting with investors, employees, suppliers, and their communities.

Appendix — SEC Updates Regulation S-K Business Description

The SEC's final rule amending Regulation S-K requires registrants to disclose a description of the company's human capital resources, including any human capital measures or objectives on which management focuses, to the extent that these are material to the company's business as a whole. In the final rule, the SEC emphasized the importance of human capital disclosure for investors and noted that human capital is typically an "important driver of performance." The amendments identify certain measures and objectives but note that these are only examples of relevant subjects, not mandates. Human capital disclosures should be tailored specifically to a company's unique circumstances.

Questions for Companies to Consider

The following are examples of questions that companies should consider when identifying and evaluating their disclosures related to human capital:

- Who needs to be involved in developing the narrative (e.g., the finance, human resources, environmental, health, and safety (EHS), sustainability and ESG functions; business leaders; boards; board committees)?
- How is existing performance measurement around human capital, when viewed through a materiality lens, driving enhanced value for the business?
- How is the company already communicating its human capital or broader ESG strategy to the market and other stakeholders?
- Has the company considered reporting information under recognized standards, such as SASB standards?
- What additional controls and procedures will the company need to institute to subject any new disclosures to the same level of internal controls as other information in the Form 10-K?

Dbriefs for Financial Executives

We invite you to participate in *Dbriefs*, Deloitte's webcast series that delivers practical strategies you need to stay on top of important issues. Gain access to valuable ideas and critical information from webcasts in the "Financial Executives" series on the following topics:

- Business strategy and tax.
- Controllership perspectives.
- Driving enterprise value.
- Financial reporting.
- Governance, risk, and compliance.
- Innovation in risk and controls.
- Tax accounting and provisions.
- Transactions and business events.

Dbriefs also provides a convenient and flexible way to earn CPE credit — right at your desk.

Subscriptions

To subscribe to *Dbriefs*, or to receive accounting publications issued by Deloitte's Accounting and Reporting Services Department, please register at My.Deloitte.com.

The Deloitte Accounting Research Tool

Put a wealth of information at your fingertips. The Deloitte Accounting Research Tool (DART) is a comprehensive online library of accounting and financial disclosure literature. It contains material from the FASB, EITF, AICPA, PCAOB, and SEC, in addition to Deloitte's own accounting manuals and other interpretive guidance and publications.

Updated every business day, DART has an intuitive design and navigation system that, together with its powerful search and personalization features, enable users to quickly locate information anytime, from any device and any browser. While much of the content on DART is available at no cost, subscribers have access to premium content, such as Deloitte's *FASB Accounting Standards Codification Manual*. DART subscribers and others can also subscribe to *Weekly Accounting Roundup*, which provides links to recent news articles, publications, and other additions to DART. For more information, or to sign up for a free 30-day trial of premium DART content, visit dart.deloitte.com.