



Developing a Framework for Human Capital Disclosure in Corporate Annual Reports

Michael Adelowotan¹

Abstract: This paper presents a framework with some indicative measures and metrics for communication human capital information to the users of Corporate Annual Reports (CARs). The methodology involved in developing this framework revolves around the use content analysis to ascertain the patterns and context of human capital disclosure (HCD) in CARS of 60 out of the top 100 Johannesburg Stock Exchange (JSE) listed companies. This analytical content analysis was undertaken to discover the extent to which disclosures in CARS relate to identified nine human capital content categories and the ninety-one underlying items. The objective is to provide a framework for human capital disclosures in Corporate Annual Reports of listed companies in South Africa. The human capital disclosure framework could be used as a model by companies in South Africa and other emerging economies in HCD in CARs.

Keywords: Human Capital; Human Capital Disclosure; Corporate Annual Reports, JSE Listed companies; South Africa

JEL Classification: E24

1. Introduction

Most companies particularly in the knowledge-based economy usually assert that human capital is their ‘most important asset’. However, majority of these companies do not provide enough information on this important asset so as to enable the investors make informed decision with regards to the value of these firms. This explains the reason why in the Integrated reporting discussions, the provision of human capital information is becoming an important element of corporate social responsibility within the general framework of the Environmental, Social and Governance (ESG) issues. Against this background, human capital reporting could be regarded as an instrument that could influence financial performance and invariably the value of a firm

Dean et al (2012) investigated the issue of the feasibility of reporting human capital in the face of the statement of financial position in CARs. They reported that over 80% of the respondents were of the opinion that human capital cannot be reported in the financial statements. Therefore, it was suggested that human capital could be reported in a separate section called ‘Human Capital Report’ where all the

¹ University of Johannesburg, South Africa, Address: PO Box 524, Auckland Park, 2006, South Africa, Corresponding author: madelowotan@uj.ac.za.

metrics and narratives in respect to human capital and its role in organizational value creation could be stated. By so doing, the crucial role of human capital in managerial decision making and long term profitability could be ascertained and appreciated by stakeholders and future investors.

Therefore, in the new economy characterized by ‘knowledge’, the players such as Accountants, Human resource practitioners, educators in finance and accounting are seeking for ways to evaluate, record and report knowledge assets in form of skills, education and training (Miller, 1996). This reporting style could be facilitated by the adoption of Integrated Reporting Practices in most countries of the world.

2. Literature Review

According to Mayo (2001), human capital has been viewed as a leading index of potential organizational value. In economic terms, it refers to the qualities, abilities, skills, competencies and attitudes of an organisation’s workforce (Boedker, 2005). These definitions could be aligned to the resource-based theory which emphasises the use of a managerial framework to determine the strategic resources a firm can exploit to achieve sustainable competitive advantage (Barney, 1991a). Human Capital has been identified as an important component of Intellectual Capital which could be strategically deployed for value addition in firms (Sveiby, 1997).

Human capital disclosures has been defined as a company’s disclosure mechanism that states various information about its human resources (Gamerschlag and Moeller, 2011). HC disclosures can assist in improving accountability in organisations and consequently increase the confidence of stakeholders (Absar, Amran & Nejati, 2014). Afiouni (2013) explained HC as a combination of knowledge, skills and abilities (cognitive components); willingness and capability to install knowledge, skills and abilities (behavioral component); alignment of cognitive and behavioral components with strategic imperatives (fit component); capability to acclimatize to various business strategies) and assessing HC’s contribution to value creation (measurement component). In summary, human capital can be referred to as the material and non-material value which employees are created by the employees of an organization through their knowledge, skills, abilities and traits.

In another study based on the human capital disclosures in the Kurdistan, the authors found out that the human capital information are grossly inadequate for effectively aiding the investment managers and analysts in organisational valuation and investment decision making. According to these authors, the information disclosed could not meet corporate governance and market expectations due to inadequate emphasis on the relevant indices and drivers of value creation and corporate performance (Mohammad, 2015). In view of the significance of human capital to organisational value creation, some organisations have purchased a ‘key man life insurance policy’ for their key employees’ in order to mitigate the effect of loss of such employees. This policy is a life insurance policy on a key employees’ with the condition that indicates the employee’s firm as the beneficiary. The organisation pays monthly or annual premiums so that upon the death of the employee, the organisation gets the face value of this policy (Israelsen & Yonker 2017).

In a study which seeks to provide a conceptual framework embedding human capital into governance design by recognising the most significant human capital attributes and linking them into governance functions. The purpose was to provide for ‘optimal human capital investments’ for organisational performance and growth. (Lajili, 2015). In another study which examines the nature and extent of

human capital reporting in the Banking sector in Bangladesh. The authors found out that all the banks reported on HC with 5 out of the 27 banks having a section of their CARs devoted the HC reporting. The study highlighted that over 90% of the reports contained quantitative metrics on HC and that the qualitative issue that was reported mostly is ‘employee training and development’ (Absar, Amran & Nejati (2014). In another linked economic growth to human capital, the authors traced the history of China’s economic growth to a strategic and systematic focus of human capital development noting that the country has achieved substantial progress in educating her citizens since the beginning of economic reforms in 1978. The consequence is an increasing levels of output through the educated labour force. This is why China’s GDP per capita has witnessed an increase of about 9 percent annually since 1978 thus making China one of the few countries that has witnessed the fastest rate of growth for such a long period of time. The authors called on the Chinese government to ‘place greater emphasis on investment in human capital as a more important driver of future growth in China (Li, Loyalka, Rozelle & Wu, 2017).

A recent paper presents three groups of quantitative and accounting based methods for valuing intangible assets. It was observed that financial information that could be associated with intangible assets are generally not visible in Corporate Annual Reports although this information could facilitate strategic management and add enormous value to the organisation. (Petkovic, Krstic & Radenovic 2020). Another recent study examined Voluntary Disclosure practices of 120 companies in Bangladesh with the aid of a Voluntary Disclosure Index consisting of 28 themes, the authors found out that profitability, industry type, leverage and size of business have significant effect on the voluntary disclosure practices of listed companies in Bangladesh (Rakiv, 2019). Other authors classified the literature on HC into three groups. The first group focused of financial measurement of HC, the second group focused on decision making through HC information and the third group on theoretical model used to determine the cause, nature and extent of HC measurement and reporting (Absar, Amran & Nejati, 2014)

In the late 2000, there had been several developments towards increasing the pace of human capital disclosures in Corporate Annual Reports. One of such developments is the response to the comments on the concept note issued by the United States Security and Exchange Commission (SEC) in 2016. The following points emanated in respect of human capital disclosures. According to SEC, issues relating to human capital are employee recruitment practices, employee benefits, employee training, grievance mechanism, human capital development, employee management, collective bargaining agreements, employees’ compensation and employees’ health and safety. Also in July 2017, the Human Capital Management Coalition sent a rulemaking petition to SEC indicating some of the information on human capital that should be disclosed. These are workforce demographics, stability, composition, skills, capabilities culture, empowerment, productivity and compensation/ incentives.

In early August 2019, SEC (USA) issued a proposal which will require a disclosure of the number of employees with a “description of the company’s human capital resources, including in such description human capital measures or objectives that management focuses on in managing the business, to the extent such disclosures would be material to an understanding of the company’s business.

Aside from its value-creation potential, the International Corporate Governance Network (ICGN) viewed HCM as an agent for long term risk mitigation through the aggregation of financial and non-financial risk disclosures in the context of integrated reporting practices. According to the ICGN, key performance indicators which should be aligned to the organisation’s HRM strategy may include

employee engagement, union representation, work-life initiatives, Investment in training and development, Lost-time injury and fatality rates, Pay ratios (across highest, media and lowest quartiles), Turnover (voluntary and involuntary, internal hire rate), Workforce compensation and incentive plans, Workforce demographics (full time, part time, agency), Workforce diversity.

Other organisations who have developed frameworks for measuring and disclosing human capital for sustainable value creation are The Embankment Project for Inclusive Capital (EPIC); The SASB's standards; The Global Reporting Initiative and the International Standards Organisation. The International Integrated Reporting Council included human capital as one of the six capitals alongside the Financial; Intellectual, Natural, Relationship and Social capitals. Interestingly, human capital could be seen as a foundation upon which these other capitals are built.

Despite the growing call for an increase in the level of HCD through both the qualitative and quantitative information, the GAAPs of many countries have not been developed as to specifically state the model and content of HC information that should be disclosed by organisations hence human capital disclosures remain a voluntary exercise.

The consequence is that it is increasing becoming difficult to estimate correctly the market values of business concerns as there exists gap between the book values and market values of organisations. A way of bridging or narrowing this gap is the ensure a comprehensive reporting on human capital intangibles.

It is noteworthy that developing economies particularly South Africa have made great improvement in Corporate Reporting Practices particularly with the Kings Report on Corporate Governance issued by the Institute of Directors South Africa. Although human capital could not be measured like tangible assets, it is a significant predictor of an organisational performance and value particularly in the new economy.

3. Methodology

The methodology involves the use content analysis to ascertain the patterns and context of human capital disclosure (HCD) in CARS of 60 out of the top 100 JSE listed companies. This analytical content analysis was undertaken to discover the extent to which disclosures in CARS relate to identified nine human capital content categories and the ninety-one underlying items.

4. Analysis

The main objective of this study is to understand the nature and the significance of human capital as value-creating intangible asset. Investors and other stakeholders are expecting much more information on human capital than what is currently being provided by the preparers of CARs. This is because there is no generally accepted principle or standard on which such disclosures can be based hence the preparers of CARs are free to exercise their discretion with regards to the level of disclosures on human capital.

Generally, the disclosures in the Corporate Annual Reports (CARs) can be divided into two categories-the statutory (mandatory) and discretionary (non-mandatory). Most times, the “facts behind the figures” are adequately explained by the information contained in the discretionary section of

CARs thereby serving a complementary role to the information provided in the statutory section of CARs to provide a more comprehensive report. Given that there is no generally acceptable standard that could afford the preparers of CARs the opportunity to provide a more comprehensive information on HC in the statutory section, this gap could be filled through the expansion of the discretionary reporting system for a comprehensive report on human capital.

This study provided a framework which includes a range of human capital items that may be included in CARs. Although the items in the framework are by no means exhaustive, they nevertheless could be regarded as a foundation for a more comprehensive human capital disclosure in CARs.

Table 1. Human Capital Disclosure Framework

Functional areas	Indicators	Objectives	Approach
Human capital strategy	Acquisition; development; management and performance.	To indicate the overall human capital strategy.	Establishment of procedure for demand and supply of human capital; HC management practices and performance measurement procedures.
Human capital features	Capability; commitment; competence; creativity; expertise; innovation; learning; Loyalty; skill; teamwork; experience and entrepreneur spirit.	To indicate specific human capital features relevant to value creation process.	Establishment of procedure to identify relevant features specific to an organisation's human capital.
Human capital relations	Workforce profile; company culture; communication channel; leadership; succession plan; meeting style; recruitment policies including interviews; union activity; community service; appreciation of employees.	To indicate relational attributes between an organisation and its employees.	Specific statements on these relational attributes.
Human capital measurements	Employee number; employee breakdown by age; seniority; gender; nationality; department; board and top management names, ages, abilities, educational background and work experience; Other attributes in this functional area includes growth or renewal ratios; efficiency ratios; human capital return on investment; training return on investment; cost of absence; cost of resignations; annual pay audits; workforce turnover; retention rates; performance and productivity as well as dependence on key	To indicate the quantitative and qualitative measures relating to human capital.	Statement of values relating to these measures.

	employee.		
Human capital training and development	Knowledge; education; qualifications; career development; training programmes; talent management; competence development programmes and job rotation opportunities	To indicate the human capital development policies in an organisation.	Reports on training and development programmes.
Human capital remuneration and welfare	Executive compensation plan, employee compensation; share scheme; share option scheme as well as asset acquisition scheme, job satisfaction and recognition and reward.	To indicate the remuneration and welfare policies in an organisation.	Reports on remuneration and welfare policies and extent of compliance to relevant legislations and regulations.
Human capital equity issues	Race; gender; religion and disability.	To indicate the organisational policies on equity issues in the workplace.	Statements on issues of race, gender, religion and disability and extent of compliance to relevant legislations and regulations.
Human capital environmental safety	Working environment policy; employee safety policy; community involvement; corporate social responsibility and ethical business policy.	To indicate the organisational policies on workplace safety.	Statements on environmental safety policies and extent of compliance to relevant legislations and regulations.
Human capital health and wellness	Social; occupational; intellectual; emotional; physical; financial as well as spiritual wellness.	To indicate the organisational health and wellness programmes.	Report on the organisational health and wellness programmes.

Source: Adelowoitan (2013)

In developing the framework, the human items have been group under nine themes such as HC strategy, HC features, HC relations, HC measurements, HC training and development, HC remuneration and welfare, HC equity, HC environmental safety and HC health and wellness.

It is important to note that users will be delighted to have knowledge of the corporate human capital strategy in the areas of recruitment, management and development. Thus the vision of the organisation for human capital as a value generator will be made clear to the users of CARs. The information provided here may also include the SWOT analysis of this important asset. It will also be relevant to provide information on the role of the HR department in overseeing the management of HC and the alignment of these roles to the achievement of corporate goals and objectives.

HC features which includes skill, learning, experience, expertise, competence, capability, teamwork, skill, commitment, innovation, entrepreneur spirit and loyalty. Other information that could be provided under the human capital relations category are appreciation of employees, union activity, meeting style, leadership, company culture, community service, recruitment policies, succession plan, communication channel.

The information provided under the human capital measurement category may include issues relating to performance and productivity, workforce turnover, cost of resignations, training return on investment, efficiency ratios, board and top management names; ages; abilities; educational

background and work experience. Others are nationality, seniority, employee number, dependence on key employee, retention rates, annual pay audits, cost of absence, human capital return on investment, growth or renewal rate, gender, employee breakdown by age.

The human capital training and development category may include information on competence development programmes, training programmes, qualifications, knowledge, job rotation opportunities, talent management, career development and education. The human capital remuneration and welfare category may include information on recognition and reward, share option scheme, employee compensation, job satisfaction, assets acquisition scheme, executive compensation scheme and share scheme. The category on equity issues may deal with issues such as disability, gender, race and religion while the next category may contain information on ethical business policy, community involvement, working environment policy, corporate social responsibility and employee safety policy. The last category provides information on employees financial, emotional, occupational, spiritual, physical and social and intellectual wellness.

In adopting this framework, it is recommended that each category should clearly report on HC items relating to it, a statement of objectives and the organisation's approach to each category within the scope of operations of firms in a specific industry. Organisations are encouraged to align the overall HC strategy to policies that are specific to these categories.

5. Conclusion and Recommendations

There has been an increased awareness of the value creation potential by the market as well as an increasing demand by investors for more information on human capital. In the same vein, there is now an increased response by standard setters and regulators through series of engagements with relevant stakeholders. The effects of this interventions will enable companies to respond with a more comprehensive reports on human capital as a strategic management tool towards achieving long-term value creation over and above the present low level of human capital disclosures in CARs. Also, there is need to provide specific information on how organisations have recruited and managed their employees and their contributions to the overall organizational performance, the impact of human capital management on the business models as well as the anticipated risks and opportunities vis-à-vis the steps taken or to be taken by the board to mitigate the risks and gain from the opportunities. Ultimately, this move will be of immense benefits to the investors and other stakeholders.

In order to achieve the objective of holistic reporting of human capital thereby making the CARs more decision-useful, there must be a continuous interaction between the preparers and the users of CARs focusing on the kind of information that will be needed for decision making by the users of CARs. More research activities have to conducted on the nature of human capital information needed by the investors and other stakeholders within and outside an organisation. Both the Finance and the HR directorates will then be in a position the produce CARs with more comprehensive information on HC.

Furthermore, the process of standardising human capital disclosures by standard setters is now becoming necessary now so that a unified definition of HC metrics will be provided to ensure consistency and facilitate firm to firm and industry to industry comparisons. This will enable organisations see HC reporting as an important aspect of reporting that must be taken seriously. When this is done, the accounting curriculum in colleges and universities will also be extended to include the principles and practice of HC reporting.

Although there had been concerns over the years by researchers followed by responses by various standard setters and regulators with regards to HCD. Some organisations have started responding in the spirit of Integrated Reporting but a lot of other organisations have not join the path leading to full disclosure of a more comprehensive and decision useful information on HC intangible. The framework provided in this study may be a starting point in this regard.

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