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To be discussed at the September 21, 2023 meeting of the Investor Advisory Committee

Recommendation of the SEC Investor Advisory Committee's Investor-as-Owner Subcommittee regarding Human Capital Management Disclosure

Executive Summary

Recent years have seen renewed interest in human capital management (HCM) disclosures.[1] In August 2020, the SEC adopted rules to modernize the disclosure of human capital under Item 101. The update, which supplemented the pre-existing requirement that issuers disclose the number of employees, required companies to disclose human capital risks and resources. And, in July 2023, the Financial Accounting Standards Board (FASB) issued a proposal to mandate that companies disaggregate the reporting of major operating costs, thus requiring companies to show employee compensation costs included in the income statement.[2]

Both initiatives are a step in the right direction, but both fall short of giving investors the full information needed for accurate valuation of human capital. For example, the 2020 rule offers virtually no guidance or prescription about what information should be disclosed, and it explicitly declines to define "human capital."[3] The lack of specificity provides companies with discretion to determine which factors are material to investors, and thus what to report. Research following the updated 2020 rule shows that issuers provide inconsistent disclosures that cannot be reliably compared—a finding that is consistent with concerns expressed by

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[1] Human capital can be considered the collective knowledge, skills, and experiences of the workforce that powers economic growth.

[2] Financial Accounting Foundation, Proposed Accounting Standards Update, FASB In Focus (July 31, 2023), https://www.fasb.org/page/PageContent?pageId=/news-media/fasbinfocus/fif-income-statement-reporting-comprehensive-income-expense-disaggregation-disclosures-subtopic-220-40-disaggregation-of-income-statement-expenses.html&bcpath=tff

[3] (Final Rule text) There has been marked increase in the volume of disclosures around human capital post-rule, but the disclosures are of varying quality and provide limited utility. Ethan Rouen, Water From a Stone: The Current Human Capital Disclosure Landscape, Harvard Business School, https://docs.google.com/presentation/d/1l99_p4-srtBxh7G1OhnO8h_WBKT-DFp6/edit#slide=id.p1 ; Thomas Bourveau, Maliha Chowdhury, Anthony Le, and Ethan Rouen, Human Capital Disclosures (September 24, 2022). Available at SSRN: https://ssrn.com/abstract=4138543. Analyses of reported information since rule implementation show that companies are not providing sufficient context in 10-Ks for investors to be able to evaluate the role of human capital in their strategies for resiliency and growth. Elizabeth Demers, Victor X. Wang, and Kean Wu, Letter to Honorable Gary Gensler, Securities and Exchange Commission (October 6, 2022), https://www.sec.gov/comments/s7-11-19/s71119-20144973-309570.pdf (see also David Gordon, Dina Bernstein, and Andrew Lash, *Variety of Approaches to New Human Capital Resources Disclosure in 10-K Filings*, Harvard Law School Forum on Corporate Governance (December 13, 2020), https://corpgov.law.harvard.edu/2020/12/13/variety-of-approaches-to-new-human-capital-resources-disclosure-in-10-k-filings; and Rob Peters, *Intelligize Report: Companies Avoid Revealing Human Capital Metrics* (April 27, 2021), https://www.intelligize.com/intelligize-report-companies-avoid-revealing-human-capital-metrics)

investors at the time the 2020 rule was adopted.[4] And FASB's proposal, although a positive development that will help investors to assess a company's margins and ability to scale, suffers from a restrictive definition of employee that does not include independent contractors.[5] Further, FASB's proposal would not provide key information such as turnover or the extent to which a firm invests in its labor force.

In sum, investors still need fundamental HCM metrics to anchor industry- and company-specific information to seize opportunities and mitigate risks. The Commission is expected to release proposed rules to strengthen the existing workforce disclosure rules soon.[6] We support this endeavor and recommend that the Commission's rule complement the existing sources of information by including the specific items noted below.

First, the IAC recommends that the Commission strengthen current Item 101(c) under Regulation S-K pertaining to human resources disclosures by requiring disclosure of the following:

1. The number of people employed by the issuer, broken down by whether those people are full-time, part-time, or contingent workers;
2. Turnover or comparable workforce stability metrics;
3. The total cost of the issuer's workforce, broken down into major components of compensation; and
4. Workforce demographic data sufficient to allow investors to understand the company's efforts to access and develop new sources of talent, and to evaluate the effectiveness of these efforts.[7]

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[4] For example, a group of investors representing over $9 trillion in assets expressed concern that the rule, while a step in the right direction, would give companies too much latitude to determine what information would be decision-useful to investors, and that the disclosures were unlikely to yield decision-useful information on a consistent basis (Human Capital Management Coalition, https://www.hcmcoalition.org/about (last visited Aug. 22, 2023). GlobeNewswire.com, Human Capital Management Coalition Statement Re: SEC's Regulation S-K Final Rulemaking (August 27, 2020) https://www.globenewswire.com/news-release/2020/08/27/2085000/0/en/Human-Capital-Management-Coalition-Statement-Re-SEC-s-Regulation-S-K-Final-Rulemaking.html. ("While the rule-making represents important progress in acknowledging the importance of the workforce, the new rules give public companies too much latitude to determine the content and specificity of the human capital-related information they report.")

[5] FASB's proposal would provide more detailed information about the costs included in commonly presented expense accounts (e.g., cost of sales, SG&A, R&D). Despite the benefits of this proposal, it is limited in scope. Shivaram Rajgopal, *The FASB's Disaggregation Proposal Is A Great First Step But Can Go Further*, FORBES (Aug. 9, 2023), https://www.forbes.com/sites/shivaramrajgopal/2023/08/09/the-fasbs-disaggregation-proposal-is-a-great-first-step-but-can-go-further/?sh=5b28c7a2379a. Not only does the proposal use a restrictive definition of employee, but the proposed line item disclosure groups together all forms of employee compensation rather than disaggregating the type of compensation to show whether, for example, stock compensation expense is concentrated primarily in a particular line item expense or allocated evenly.

[6] *See* Spring 2023 Agency Rule List, U.S. Securities and Exchange Commission, https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202304&RIN=3235-AM88.

[7] This information may include diversity across gender, race/ethnicity, age, disability, and/or other categories viewed as important to investors and relevant to the business. It also could provide a limited exception for disclosure of workforce composition outside the United States to consider laws and regulations in non-U.S. jurisdictions. For

Second, the IAC recommends that the Commission consider narrative disclosure, in the Management Discussion & Analysis, of how the firm's labor practices, compensation incentives, and staffing fit within the broader firm strategy. Such a discussion would address what portion of labor costs management views as an investment and why, including how labor is allocated across areas designed to promote firm growth (e.g., R&D) and those necessary to maintain current operations rather than increase sales revenue (e.g., compliance).[8] Our recommendation here is consistent with the recommendation put forward in a June 2022 rulemaking petition submitted by former SEC commissioners and senior officials as well as professors of accounting and securities law.[9]

Part I. Background on Human Capital Disclosures

The discussion below begins with context for our recommendation and concludes with a discussion on the reasoning behind each specific item requested.

Investor Interest in Human Capital Disclosures

A growing body of work provides evidence that companies with effective human capital management perform better than those that manage their human capital poorly.[10] For example, investments in human capital are associated with numerous measures of profitability such as higher risk-adjusted returns, return on assets, and return on invested capital.[11] Human capital investments are further associated with increased workforce productivity and higher customer satisfaction.[12]

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example, in Japan, where ensuring the full participation of the workforce across sex is a national priority, companies will be required to disclose metrics related to gender equity & inclusion starting in 2024.

[8] This narrative disclosure would allow investors better insight as to what portion of labor costs should be capitalized in their own financial models—thus allowing investors to treat investment in labor akin to investment in capital expenditures. We anticipate that this narrative disclosure would have a discussion on how emerging technologies will affect firm strategy with respect to labor.

[9] The Working Group on Human Capital Accounting Disclosure, Petition for Rulemaking (June 7, 2022), https://www.sec.gov/files/rules/petitions/2022/petn4-787.pdf

[10] The Human Capital Management Coalition, Rulemaking Petition to the Sec. & Exch. Comm'n (July 6, 2017), https://www.sec.gov/files/rules/petitions/2017/petn4-711.pdf

[11] Alex Edmans, *Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices*, 101 J. FIN. ECON. 621 (2011), http://faculty.london.edu/aedmans/Rowe.pdf; Aaron Bernstein and Larry Beeferman, THE MATERIALITY OF HUMAN CAPITAL TO CORPORATE FINANCIAL PERFORMANCE, President and Fellows of Harvard College (April 2015), https://lwp.law.harvard.edu/files/lwp/files/final_human_capital_materiality_april_23_2015.pdf; Laurie Bassi and Dan McCurrer, Human Capital Management Predicts Stock Prices (June 2010), https://mcbassi.com/wp/wp-content/uploads/2018/07/HCMPredictsStockPrices.pdf; Letter from Dr. Anthony Hesketh, Lancaster University Management School to Anne Sheehan, Chairman, Investor Advisory Committee, Sec. & Exch. Comm'n (March 21, 2019) https://www.sec.gov/comments/265-28/26528-5180428-183533.pdf

[12] Laurie J. Bassi, Jens Ludwig, Daniel P. McCurrer, and March Van Buren, *Profiting from Learning: Firm-Level Effects of Training Investments and Market Implications*, 24(3) SINGAPORE MANAGEMENT REV. 61 (2002), https://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.533.7777&rep=rep1&type=pdf; Aon Hweitt, 2015

Investors are already pursuing data on workforce and spending money and resources on the data they can find.[13] Probing into the quality of human capital is a standard part of operational due diligence for allocators choosing investment managers.[14] However, the lack of

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TRENDS IN GLOBAL EMPLOYEE ENGAGEMENT (2015) https://www.aon.com/attachments/human-capital-consulting/2015-Trends-in-Global-Employee-Engagement-Report.pdf; Vidya Mani, Sarananan Kesavan, and Jayashankar M. Swaminathan, Estimating the Impact of Understaffing on Sales and Profitability in Retail Stores, 24(2) PRODUCTION & OPERATIONS MANAGEMENT 201 (2015) https://doi.org/10.1111/poms.12237; Mark Huselid, The Impact of Human Resources Management Practices on Turnover, Productivity, and Corporate Financial Performance, 38(3) ACAD. OF MGT. J. 635 (1995) https://www.markhuselid.com/pdfs/articles/1995_AMJ_HPWS_Paper.pdf; *jetBlue Profit to Engagement Linkage*, Case Study, HUMAN CAPITAL MANAGEMENT INSTITUTE, https://www.hcmi.co/Resources/Case-Studies/Profit-to-Engagement-Linkage; Mark Huselid and Brian E. Becker, *The Strategic Impact of High Performance Work Systems* (1995) https://www.bhbassociates.com/docs/articles/1995_Strategic_Impact_of_HR.pdf

[13] *See, e.g.* Letter from John Streur, President and CEO of Calvert Research and Management, to Hon. Gary Gensler, Chair, U.S. Securities and Exchange Commission regarding Human Capital Disclosure ("Calvert Letter") (Aug. 30, 2021), 5, https://www.sec.gov/comments/climate-disclosure/cll12-9190246-249462.pdf. ("Since retention and turnover data is not widely available but has been determined to be financially material, Calvert analysts have developed proxies for turnover to support our analysis of companies and their ESG performance. One example of such a proxy is an in-house proprietary indicator that was developed for the real estate sector to measure and track the forfeiture of stock option grants in order to glean the level of professional turnover at companies that offer stock options as a component of compensation. There are obvious limitations to this approach, as it would not apply to sectors and companies where stock options are not a component of compensation. Having a standardized, publicly reported metric for turnover would enhance our ability to more directly measure performance of this important human capital management factor across all sectors.") Confidential interviews conducted by IAC members further support this point. A senior investment industry professional at a mid-sized U.S.-based investment firm reported spending over $1.3MM across four sources for human capital-related data for use in quantitative analysis, observing that the data was still incomplete. The professional noted that this cost only covered data, not the staff time necessary to integrate it, stating, "this is why we need companies to disclose the data directly." (Confidential Interview with Senior Investment Integration Professional. Conducted by Cambria Allen-Ratzlaff [phone], 13 Sept. 2023. Interview notes on file with IAC Investor as Owner Subcommittee Chair) More generally, industry experts and academics have acknowledged that the lack of a comparable source for standardized human capital information forces key actors in the investment process to rely on limited approximations of critical data that are often costly, inefficient, and unreliable. *See, e.g.,* Jack Ciesielski, In Search of Practical Information, Barron's (Oct. 12, 2013) ("Managers like to say that 'our greatest assets are our people,' yet they tell their shareholders nothing about the total cost of those greatest assets – until they are eliminated in restructuring actions."); Shivaram Rajgopal, Why the Public Reporting Model is Broken and How to Fix it, Fortune (Jan. 24, 2020) ("[L]abor costs . . . are tangled up in every functional line item on the income statement where labor is employed, leaving pieces to a puzzle scattered throughout a disclosure. . . .Very few U.S. firms gather the puzzle pieces together for the investigating investor or analyst to provide a cohesive, total picture of labor costs, stripped away from function.").

[14] As explained by the chief investment officer of a large public pension fund in Illinois, "[w]hen we think of investing and evaluating private equity managers, we are cognizant of the long-term nature of these opportunities. It's not only the next quarter that we are locking up capital, but we are taking advantage of an illiquidity premium that will more than likely last beyond 10-15 years. A part of our diligence process is understanding how a general partner's value creation plan is affected by human capital and workforce considerations to maximize value. We are addressing and trying to mitigate risk but also identify areas to add durable value within a long-term investing complex. When we discuss with general partners, they are evaluating workforce metrics similar to that of traditional business metrics to better assess opportunities to add value or mitigate risks when it comes to workplace safety, employee satisfaction, and alignment of interests." Joe Aguilar, email message to author, September 14, 2023. At a May 2023 workforce event hosted by the Human Capital Management Coalition and the University of Michigan Ross School of Business Business+Impact Program, institutional asset owner and asset manager attendees reported using the Institutional Limited Partners Association (ILPA) model due diligence questionnaire (DDQ) and diversity

standardized human capital information forces capital market participants to rely on limited approximations of critical data that are often costly, inefficient, and unreliable.[15]

Because such data are elusive, it is unlikely that human capital is fully priced into the market.[16] Indeed, research has found that an investment strategy built on firms' human capital investments yields abnormal returns from 3.5 to 7.8%,[17] and recent years have seen the growth of investment strategies and themed products based around available human capital. As of the end of Q3 2022, asset managers had launched at least 20 funds with a human capital focus in their investment strategies; another 34 asset managers incorporated workforce-related criteria.[18]

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survey as a starting point for consideration of HCM-related policies and practices. The model questionnaire contains detailed questions on HCM issues and can be used to assess the HCM practices of the asset management firm itself and/or the practices of its investee companies, where applicable. *See* Draft Report, "Summit on Workforce Valuation and Reporting Summary Report" (on file with authors). The DDQ includes "the most frequent and important diligence questions posed by investors of managers." ILPA represents nearly 600 institutional investors (public pension funds, endowments and foundations, private pension funds, family offices, insurance companies and other institutional investors) that manage capital on behalf of their beneficiaries, which include retirees, teachers, firefighters, police officers, universities, charities, and insurance policyholders. https://ilpa.org/due-diligence-questionnaire/

[15] Analysts and researchers are forced to rely on crude workarounds to fill the human capital reporting gap, such as using Glassdoor, Indeed, and LinkedIn to create proxies for needed human capital disclosures to "guestimate what a company's labor costs are". Council of Institutional Investors, *The Voice of Corporate Governance*, https://www.cii.org/podcasts/ See also, Shivaram Rajgopal, *Why The Public Reporting Model is Broken and How to Fix It*, FORBES (January 24, 2020) https://www.forbes.com/sites/shivaramrajgopal/2020/01/24/why-the-public-reporting-model-is-broken-and-how-to-fix-it/?sh=3d319fe85b09. One asset manager reported that because retention and turnover data is typically unavailable but is financially material, its financial analysts have developed various proxies for turnover that are narrowly scoped to a particular industry or type of employee, and therefore limited in application. John Streur, Calvert Research and Management, Letter to Chairman Gary Gensler, Sec. & Exch. Comm'n (August 31, 2021), https://www.sec.gov/comments/climate-disclosure/cll12-9190246-249462.pdf. In a recent interview on workforce data integration, a senior investment professional at a midsized U.S.-based asset management firm stated, "we have our materiality map and try to back it up by academic and industry evidence to make it less subjective than it was. Now [we are] going back to this and partnering with our [quantitative scientists] and asking them to use natural language processing to scan that company's legal filings and say, 'does the company themselves disclose [human capital] as a risk?' … if the company is disclosing this themselves as a risk it takes all subjectivity out of it; … as fundamental investors that should be incorporated as part of our investment process. We are less than a quarter of the way through our project, but what we've seen consistently is that companies are disclosing either human capital or labor risk throughout their filings. … what we're finding is that human capital and labor are [consistent risks across every subsector]." (Confidential Interview with Senior Investment Integration Professional. Conducted by Cambria Allen-Ratzlaff [phone], 13 Sept. 2023. Interview notes on file with IAC Investor as Owner Subcommittee Chair)

[16] Matthias Regier and Ethan Rouen, *The Stock Market Valuation of Human Capital Creation*, 79 J. CORP. FIN. (2023), https://www.sciencedirect.com/science/article/pii/S0929119923000330.

[17] *Id.*

[18] It is notable that CalPERS, Schroders, and Oxford University released a framework to quantify financial returns from human capital. https://www.institutionalinvestor.com/article/2bwv3pmbyt4tb69o4fim8/portfolio/companies-that-take-care-of-their-employees-perform-better-schroders-and-calpers-want-to-capitalize-on-that

The Need to Modernize Human Capital Disclosures

Given the circumstances, it is no surprise that investors continue to demand high-quality, decision-useful human capital disclosures. After all, financial reporting should reflect the ways modern companies create value. Due to two key trends, the importance of human capital—and thus the need for greater disclosures in this area—seems only likely to increase going forward.

First, the ongoing modernization of our economy—and overwhelming percentage of company valuation now held in intangibles—underscores the urgent need for higher-quality workforce information from U.S. public companies. In 1973, when issuers were first mandated to disclose headcount, over 80% of the S&P 500's market capitalization was held in tangible assets such as property, plant, and equipment.[19] By contrast, in 2020, 90% of the S&P 500 was based on intangible assets such as human capital.[20] Yet, the only metric that companies must disclose remains headcount.[21]

The growing importance of human capital can also be seen in firms' labor costs. From 1992 to 2018, capital expenditures have remained flat at roughly 10% of sales. By contrast, personnel expense as a percentage of sale increased from roughly 26% to 38%.[22] These statistics underscore the need for updated reporting. Human capital represents a substantial asset (and a key operating cost) that cannot be found on firms' disclosed financials.

Second, the growth of net loss firms highlights the need for updated human capital reporting. In 2020, for the first time, more than half of listed firms reported negative net income under Generally Accepted Accounting Principles (GAAP).[23] One explanation for the growth of net loss firms is that these are younger firms that will scale as they age, eventually becoming profitable. Valuing these firms is particularly difficult, as common valuation techniques such as price-to-earnings multiples cannot be used. Instead, to evaluate these firms' future financial prospects, investors must understand the firms' margins and the degree to which these firms report negative net income because they are engaging in the type of investment, such as research and development or investment in human capital, that GAAP commonly treats as an expense that reduces net income.

Although FASB's disaggregation proposal will help provide needed transparency if enacted, current accounting rules do not provide sufficient visibility into labor costs. Firm investments in tangible assets, such as investments in Property, Plant and Equipment, are typically capitalized and remain as assets on the balance sheet. By contrast, internal firm investments in intangible assets such as Research & Development and human capital are typically expensed and do not appear on the balance sheet—as though they provide no future value.

[19] Report, Intangible Asset Market Value Study, Ocean Tomo, https://oceantomo.com/intangible-asset-market-value-study/
[20] *Id.*
[21] SEC Final Rule to Modernization of Regulation S-K Items 101, 103, and 105, https://www.sec.gov/files/rules/final/2020/33-10825.pdf
[22] Regier and Rouen, *supra* note 16, see figure 1, using firms that report under IFRS).
[23] Colleen Honigsberg & Shivaram Rajgopal, *Wage Wars*: The *Battle Over Human Capital Accounting*, *12 Harv*. *Bus*. *L*. *Rev*. 275-314 (2022).

Moreover, while firms are at least required to disclose their spending on research and development, human capital costs are not broken out from other expenses.[24]

In sum, because accounting rules aggregate labor costs with a slew of additional administrative expenses, investors cannot identify how much a firm invests in its workforce from its financials. Investors, however, need the ability to tease out labor costs from other operating expenses, particularly for lossmaking firms. This will provide more visibility into whether lossmaking firms are truly lossmaking or whether these firms show a loss under GAAP because they are investing in their future growth.

Prior IAC Action on Human Capital Disclosures

Given the clear value of human capital, it is no surprise that the IAC has addressed this topic previously. In March 2019, the IAC recommended that the SEC pursue rulemaking to improve human capital disclosures for investors.[25] In the recommendation, the IAC observed:

> In contrast to the financial markets' view of human capital as a source of value, the Securities and Exchange Commission's historical approach to the workforce has been to view human capital as a cost. The Commission's disclosure frameworks – both quantitative and qualitative – have not kept pace with the shift towards human capital management (HCM) as a primary source of value. Valuation of firms with few hard assets based on public SEC-mandated disclosure alone is increasingly difficult. Currently available information is not consistent, verified, or comparable across companies. Differences in HCM make existing disclosure requirements, such as the 10-K requirement to disclose the number of employees, difficult for investors to interpret or use. Yet HCM metrics such as those outlined below are a routine part of financial due diligence, such as in M&A transactions, including for basic valuation models.

While the SEC did act on some of the recommendations put forth by the IAC, as noted above, the current disclosure regime has not met its full potential to provide *investors*—the ultimate users of issuer disclosures—the information they need for investment, engagement or voting purposes. The principles-based approach the Commission elected to take in 2020, while a step in the right direction, gives companies too much latitude and not enough direction regarding what information would be decision-useful to investors. Investors still need fundamental, baseline metrics reported by each company to anchor industry- and company-specific information to seize opportunities and mitigate risks.

In sum, by strengthening the set of available information, and ensuring that the information is reliable, verifiable, consistent, comparable, and timely, the SEC would allow

[24] *See also* Letter from Sen. Mark Warner to Hon. Jay Clayton, Chairman, Sec. & Exch. Comm'n 3 (July 19, 2018).
[25] Recommendation of the investor Advisory Committee, Human Capital Management Disclosure (March 28, 2019), https://www.sec.gov/spotlight/investor-advisory-committee-2012/human-capital-disclosure-recommendation.pdf

investors to more efficiently direct capital.[26] Such consistency and comparability are key; at present, investors must pore through reams of documents to find basic workforce information,[27] a highly inefficient process that favors large institutional investors who can demand (and afford) more data relative to smaller retail investors.

Reporting Costs

Of course, it is necessary to consider resource constraints and balance the benefits of human capital disclosure with the costs of providing that information. However, technological advancement has significantly decreased the cost of collecting—and, ostensibly, reporting—basic human capital data. Analytic tools developed in-house or through services such as ADP, SAP, Oracle, and Workday are commonly utilized to assist with data collection, and firms could leverage the human resources tools and services already in place to satisfy new human capital reporting requirements.

In addition, many U.S. companies track basic workforce data for administrative purposes. Issuers must collect workforce cost information for tax reporting purposes, and most firms already undertake "significant" audits of their payroll system.[28] And private sector employers with over 100 employees are required to report DEI data stratified by occupation/function to the EEOC.[29] Further, U.S. filers already collect workforce cost data to satisfy mandated proxy statement reporting of the CEO-to-median worker pay ratio, [30] and multinational companies that report under IFRS accounting standards already collect and report significant human capital information in their financials.[31]

Finally, the costs to issuers should be balanced against the benefits of providing the disclosures. At present, investors incur significant costs hunting for data that issuers can provide far more accurately.[32] It would be more efficient for issuers to provide human capital information directly. And the administrative costs to companies of providing workforce cost data are eclipsed by the anticipated economic returns generated from decision-useful human capital disclosure.

[26] To ensure the reliability of the recommended human capital quantitative disclosures, we recommend that they be subject to reasonable assurance.
[27] *See* Honigsberg and Rajgopal, *supra* note 23.
[28] Letter from Dr. Anthony Hesketh, Lancaster University Management School to Anne Sheehan, Chairman, Investor Advisory Committee, Sec. & Exch. Comm'n (March 21, 2019), https://www.sec.gov/comments/265-28/26528-5180428-183533.pdf
[29] EEO-1 Data Collection, U.S. Equal Employment Opportunity Commission, https://www.eeoc.gov/data/eeo-1-data-collection
[30] *See*, e.g., final pay ratio rule (https://www.sec.gov/rules/final/2015/33-9877.pdf), SEC staff interpretive guidance (https://www.sec.gov/rules/interp/2017/33-10415.pdf and https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm#128c.01), and Division of Corporation Finance Guidance on Calculation of Pay Ratio Disclosure (https://www.sec.gov/corpfin/announcement/guidance-calculation-pay-ratio-disclosure).
[31] https://www.ifrs.org/issued-standards/list-of-standards/ias-19-employee-benefits/
[32] For example, it took a team of two highly-skilled data analysts over 130 hours to collect data for 28 human capital metrics at 100 companies in July/August 2021. Aleksandra Radeva, "Investors are Turning Their Focus to Human Capital," (February 17, 2022), https://justcapital.com/news/why-human-capital-data-collection-time-matters-for-sec-standards/.

II. Rationale for Each Disclosure Item Requested

In this section, we describe the rationale for each disclosure metric requested. We recommend that the Commission mandate multiple metrics because investors need multiple data points to assess a firm's human capital; no single metric alone can fully express the value of this asset.

The number of people employed by the issuer, broken down by whether those people are full-time, part-time, or contingent workers.[33]

The SEC's current headcount requirement has led to inconsistent disclosures. In a 2016 Concept Release soliciting feedback on ways to improve business and financial disclosures required by Regulation S-K, the Commission observed that the headcount data disclosed by companies may vary substantially.[34] For example, some companies report the number of full-time and part-time employees overall, while others report headcount by business unit or division. Still others report numbers only for their domestic workforce, and others report information that includes international employees. Inconsistencies with respect to the reporting of contingent labor have persisted despite 2008 SEC staff guidance stating that industries typically reliant on independent contractors should disclose these numbers as well.[35] Disclosures made since the 2020 Regulation S-K amendments continue to reflect these same problems.[36]

Investors have routinely requested that headcount be broken down into full-time, part-time, and contingent workers because this breakdown allows investors to contextualize information about workforce changes.[37] For example, the movement of large number of

[33] This would include reporting on all similarly situated persons whose work contributes to a material level of revenue or income.

[34] Comments on Concept Release: Business and Financial Disclosure Required by Regulation S-K, Sec. & Exch. Comm'n, Release No. 33-10064; 34-77599; File No. S7-06-16, https://www.sec.gov/comments/s7-06-16/s70616.htm

[35] Regulation S-K, Sec. & Exch. Comm'n (August 25, 2023) https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp *See* 203.01: "In industries where registrants' general practice is to hire independent contractors (sometimes called "contract employees" or "freelancers") rather than "employees" to perform the work of the company, this disclosure should indicate the number of persons retained as independent contractors, as well as the number of regular employees.") For example, investors only discovered Alphabet/Google employed roughly the same number of contractors as direct hires when an employee leaked workforce composition information in the midst of labor controversies at the firm in 2018 (Mark Bergen and Josh Eidelson, *Inside Google's Shadow Workforce*, BLOOMBERG (July 25, 2018) https://www.bloomberg.com/news/articles/2018-07-25/inside-google-s-shadow-workforce#xj4y7vzkg). Interestingly, Google perhaps could have reported on the number of these employees as the company already had a category for them: "TVCs" ("temps, vendors, and contractors").

[36] *See, e.g.,* https://corpgov.law.harvard.edu/2020/12/13/variety-of-approaches-to-new-human-capital-resources-disclosure-in-10-k-filings/, https://www.intelligize.com/intelligize-report-companies-avoid-revealing-human-capital-metrics/, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4138543.

[37] Email to the Secretary, Sec. & Exch. Comm'n from the Committee on Securities Law of the Business Law Section of the Maryland State Bar Association (July 21, 2016), https://www.sec.gov/comments/s7-06-16/s70616-257.pdf

employees from full-time to part-time could indicate a downward shift in operations, and the volume of independent contractors provides insight into management's assessment of the stability of current operations. Research shows that "[a]bnormal reductions in the number of employees" are useful in predicting financial misstatements while overall reductions in the number of employees may be an indicator of declining demand for a firm's products.[38] Failure to distinguish between the type of employee could obscure these trends—and may be misleading regarding the size and scale of operations. The lack of visibility also hampers investors' ability to conduct ratio analysis with respect to human capital (e.g., "ROIT", return on invested talent).[39]

Given the inconsistent disclosures and the relevance of this information for valuation, it is imperative that the SEC provide issuers with updated guidance along the lines we recommend.[40]

Turnover or comparable workforce stability metrics.

Despite the limited data available, studies provide consistent evidence that turnover is meaningfully related to financial performance. Better employee retention is associated with higher stock returns,[41] whereas higher turnover is associated with lower measures of profitability (e.g., return on assets and sales growth)[42] and lower product reliability.[43] On average, it may cost firms from one half to up to over two times an employee's annual salary to replace them; Gallup

[38] Patricia M. Dechow, Weili Ge, Chad R. Larson, and Richard G. Sloan, *Predicting Material Accounting Misstatements*, 28 CONTEMP. ACCT. RSCH. 17 (2011), https://www.thecaq.org/wp-content/uploads/2018/03/Dechow-et-al-2011-Contemporary_Accounting_Research.pdf

[39] Underreporting the full breadth of labor utilized by the firm provides a misleading view of labor productivity. For example, a firm that uses contingent labor for core operations may look more productive than a firm that uses the same amount of labor from direct employees even if the amount of labor in both cases is the same.

[40] It is unlikely companies will disclose additional information about the sources of labor beyond headcount—which in many cases may go well beyond direct hires ("purchased" labor) into labor provided from contingent/contracted sources ("leased" labor)—absent more explicit instruction from the Commission.

[41] A study of employee retention at 2,000 publicly-traded companies over a 10-year period found companies with better employee retention saw cumulative stock returns that were 25 percent higher, or 2.8 percent annualized, than those with the lowest retention. Morgan Stanley Investment Management, Counterpoint Global Insights: Culture Quant Framework (April 2022), https://www.morganstanley.com/im/publication/insights/articles/article_culturequantframework_en.pdf?1614791686701

[42] Qin Li, Ben Lourie, Alexander Nekrasov, and Terry J. Shevlin, *Employee Turnover and Firm Performance: Large-Sample Archival Evidence*, MGMT. SCI., forthcoming, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3505626 (analysis of turnover at over 3,600 firms over a ten-year period, academics found that higher turnover is associated with lower future financial performance. The negative association between turnover and performance is stronger for small firms, for young firms, for firms with low labor intensity, when the local labor supply is tight, and when the firm likely needs to replace the departing employees. The significant negative association between turnover and performance disappears when turnover is very low)

[43] Angie Basiouny, *Employee Turnover Costs More Than You Think,* KNOWLEDGE AT WHARTON (August 2, 2022), https://knowledge.wharton.upenn.edu/article/why-employee-turnover-costs-more-than-you-think/ (the greater incidence of product failure provides evidence that high turnover costs may go well beyond recruitment and training replacement employees)

estimates turnover costs U.S. businesses over $1TT annually.[44] Beyond direct replacement costs, high rates of undesired turnover can be costly for companies due to loss of knowledge and social capital, lower productivity, and reduced product and/or service quality.[45] For the average company, the combined costs of turnover represent more than 12% of pretax income.[46]

Not only is turnover financially meaningful, but it is a numeric human capital metric that can be compared across companies. Indeed, the Embankment Project for Inclusive Capitalism (EPIC) reported that analysts want turnover data precisely because it is numeric. Of course, it is necessary to have sufficient context to understand the number within the context of the company's business and human capital strategy, but turnover that is inconsistent with peer companies can be a red flag.[47] Turnover is a value-relevant and numeric disclosure that the Commission should require.

The total cost of the issuer's workforce, broken down into major components of compensation.

Labor costs are likely the most significant operating cost that companies incur.[48] Yet, this major cost is not disclosed under GAAP.[49] Instead, labor costs are typically aggregated with other income statement line-item expenses, such as Cost of Goods Sold or Selling, General & Administrative Costs. As a result, only about 15% of S&P 500 firms disclose workforce costs.[50] Aggregating these expenses together means that investors cannot determine whether an expense such as Cost of Goods Sold increased because of a higher utility bill (a pure expense) or because a firm provided its employees with additional compensation (arguably an investment in employee retention and productivity). Disclosure of workforce costs would allow investors to

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[44] Shane McFeely and Ben Wigert, *This Fixable Problem Costs U.S. Businesses $1 Trillion*, GALLUP WORKPLACE (March 13, 2019), https://www.gallup.com/workplace/247391/fixable-problem-costs-businesses-trillion.aspx LinkedIn provides a toll to help calculate the cost of employee attrition and disengagement. Interactive Workbook, Calculating the Cost of Employee Attrition and Disengagement, LinkedIn Learning slide deck, https://learning.linkedin.com/content/dam/me/learning/en-us/pdfs/lil-workbook-calculating-cost-of-employee-attrition-and-disengagement.pdf

[45] Tae-Youn Park and Jason D. Shaw, *Turnover Rates and Organizational Performance: A Meta-Analysis*, 98(2) J. APPLIED PSYCH. 268 (2013), https://leeds-faculty.colorado.edu/dahe7472/Park%20and%20Shaw%20Turnover%20rates%20and%20organizational%20performance_%20A%20meta-analysis%202013.pdf

[46] Society for Human Resource Management, *Saratoga Driving the Bottom Line: Improving Retention*, PricewaterhouseCoopers LLP (2006) https://www.shrm.org/hr-today/news/hr-magazine/Documents/saratoga-improving-retention.pdf

[47] For example, Wells Fargo's retail banking turnover was higher than other banks, which was later found to reflect the company's toxic sales culture that led to widespread fraud.

[48] Regier and Rouen, *supra* note 16, showing that personnel expense is close to 40% of sales using IFRS data.

[49] In contrast, IFRS requires more extensive labor disclosures. *See*, IAS 19 Employee Benefits, The International Financial Reporting Standards Foundation (2023), https://www.ifrs.org/issued-standards/list-of-standards/ias-19-employee-benefits/.

[50] Letter from Dr. Anthony Hesketh, Lancaster University Management School to Anne Cheehan, Chairman, Investor Advisory Committee, Sec. & Exch. Comm'n (March 21, 2019), https://www.sec.gov/comments/265-28/26528-5180428-183533.pdf.

understand these costs—and to evaluate the efficiency of each dollar invested in human capital through various productivity measures (ROI, return on invested talent, etc.).[51]

Not only do investors need disclosure of total workforce costs, but they need total costs to be broken down by major components (e.g., salary, equity, etc.). This type of disclosure has long been required for executive compensation because it allows investors to better understand the executives' incentives. Similarly, understanding the components of employee compensation would allow investors to understand employees' incentives.[52] In addition, understanding the forms of compensation would better allow investors to understand how a company invests in its workforce, and whether any of that investment should be capitalized in the investors' own financial models.[53] In sum, we recommend that the SEC supplement accounting standards and provide investors with the workforce cost information that FASB's disaggregation proposal omits.

Workforce demographic data sufficient to allow investors to understand the company's efforts to access and develop new sources of talent, and to evaluate the effectiveness of these efforts.

Employees are a key source of value, and investors need to understand companies' efforts to identify and develop new sources of talent. Diversity disclosures provide insight along these lines. Empirical research shows the value of diversity across countries,[54] especially diversity among senior leadership and management,[55] perhaps due to the benefits of diversity in decision making.[56] Data on diversity at all levels allows investors to evaluate a firm's talent pipeline and effectiveness of DE&I efforts.

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[51] Technical Committee ISO/TC 260, *Human Resource Management — Guidelines For Internal and External Human Capital Reporting*, INTERNATIONAL ORGANIZATION FOR STANDARDIZATION (December 2018), https://www.iso.org/standard/69338.html.

[52] Ilias Vlachos, *The Effects of Human Resource Practices on Firm Growth*, 4(2) INT. J. OF BUS. SCI. & APPLIED MGMT. 18 (2009), https://www.researchgate.net/publication/26553215_The_Effects_of_Human_Resource_Practices_on_Firm_Growth (finding that compensation policy was the strongest predictor of sales growth)

[53] We do not ask for investment in employees to be capitalized under GAAP. However, we ask that this information be made public so that investors, if they so choose, can capitalize these costs in their own models.

[54] Companies in the top quartile for ethnic and cultural diversity on executive teams are 36 percent more likely to outperformance on EBIT margin— up from 33 percent in 2017 and 35 percent in 2014 (data based on companies in US, UK, Brazil, Mexico & Singapore; Sundiatu Dixon-Fyle et al., Diversity Wins: How Inclusion Matters, MCKINSEY & COMPANY (May 2020) https://www.mckinsey.com/~/media/McKinsey/Featured%20Insights/Diversity%20and%20Inclusion/Diversity%20wins%20How%20inclusion%20matters/Diversity-wins-How-inclusion-matters-vF.pdf

[55] Rocio Lorenzo et al., The Mix That Matters: Innovation Through Diversity, BOSTON CONSULTING GROUP (April 26, 2017), https://www.bcg.com/publications/2017/people-organization-leadership-talent-innovation-through-diversity-mix-that-matters (finding that companies with more than 20% women in management (not only executive management) enjoyed higher rates of innovation, as measured by revenue from new products/services), (finding that Companies in top quartile of gender diversity on executive teams were 25% more likely to experience above-average profitability than peer companies in the fourth quartile and that companies in the top quartile for ethnic diversity on executive teams outperformed those in the bottom quartile by 36% percent based on profitability), *see* Dixon-Fyle et al. *supra* note 54.

[56] Large U.S. public companies have argued that racial and ethnic diversity enhances business performance, and have affirmed that they are investing in diversity initiatives in hopes to capitalize on that increased performance.

Mandating diversity disclosures is not novel. In adopting the 2020 Regulation S-K rule amendments, former SEC Chairman Jay Clayton acknowledged that D&I are "value-enhancing" and that he "expects" public companies that deem D&I to be material to the business and a driver of performance to include this in disclosures.[57] Indeed, academic research examining issuers' changes to human capital disclosures following the Commission's 2020 adoption of rules to modernize human capital reporting shows that diversity-related disclosures have emerged as one of the most common human capital disclosures.[58] However, in many cases, company disclosures on diversity are generic, qualitative, varied with respect to the level of detail, and lack specific metrics;[59] these disclosures do not provide the level of decision-useful information that investors seek. Therefore, we recommend that the Commission work to provide investors with information on the composition of the workforce sufficient to assess the company's ability to source and develop diverse talent across the firm enterprise, including diversity at senior levels.

From amici brief: "Empirical studies confirm that diverse groups make better decisions thanks to increased creativity, sharing of ideas, and accuracy. And diverse groups can better understand and serve the increasingly diverse population that uses their products and services. *These benefits are not simply intangible; they translate into businesses' bottom lines*." (emphasis added) 143 S.Ct. 2141, Students for Fair Admissions, Inc. v. President and Fellows of Harvard College, Brief for Major American Business Enterprises as *Amici Curiae* Supporting Respondents, https://www.supremecourt.gov/DocketPDF/20/20-1199/232357/20220801135424028_Nos.%2020-1199%2021-707%20-%20Brief%20for%20Major%20American%20Business%20Enterprises%20Supporting%20Respondents.pdf

[57] Sec. & Exch. Comm'n, 2020 08 26 Open Meeting, YOUTUBE (December 13, 2021), https://www.youtube.com/watch?v=allhe_0QZSw

[58] *See* Ethan Rouen, Water From a Stone: The Current Human Capital Disclosure Landscape (visualizing a marked increase in DEI disclosures post-rulemaking, https://docs.google.com/presentation/d/1l99_p4-srtBxh7G1OhnO8h_WBKT-DFp6/edit#slide=id.p6). *Also see* JUST Capital, "The Corporate Guide to Human Capital Disclosure" (August 31, 2023), https://justcapital.com/reports/corporate-guide-to-human-capital-disclosure/ ("[S]ome of the highest disclosure rates are clustered within Workforce Composition; specifically, workforce diversity data points (which include EEO-1 data or similarly detailed demographic data) are the most commonly disclosed….72% of companies [in the Russell 1000] disclose some race/ethnicity workforce demographic data, ranging from the number/percentage of overall minority in the workforce to highly disaggregated intersectional data, such as that reported in an EEO-1 Component 1.")

[59] JUST Capital, "The Corporate Guide to Human Capital Disclosure" (August 31, 2023), https://justcapital.com/reports/corporate-guide-to-human-capital-disclosure/ ("The disparate sources and lack of standardization across companies further complicate stakeholders' ability to understand job quality at a given organization….")