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A study of human capital reporting in the United Kingdom

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ABSTRACT

Recently, there have been attempts at increasing human capital (HC) reporting in the United Kingdom (UK) through the introduction of government legislation and other initiatives. This paper assesses the current state of HC reporting in the UK by analysing the annual reports of the Financial Times Stock Exchange 100 companies before and after relevant amendments to the Companies Act 2006. The findings show that most of the companies analysed have been increasing their HC reporting, going beyond their statutory duties and moving away from wider intellectual capital disclosures to focus more on HC issues. However, these changes were not universal.

1. Introduction

It could be argued that one of the fundamental roles of an accountant is to record, measure and report a company's assets, but in an increasingly complex and turbulent environment many organisations do not know the value of their most valuable asset, human capital (HC). The market value of leading organisations has for several decades been far higher than the value of their physical assets and this has led to calls for HC, along with other intangible items, to be included on balance sheets to give a more accurate impression of organisational value (Seetharaman, Bin Zaini Sooria, & Saravanan, 2002). HC is a subset of intellectual capital (IC), and includes the stock of attributes that employees provide, such as skills, knowledge, experience, commitment and leadership, in exchange for wages and salaries (Roslender, Stevenson, & Kahn, 2012). Given the above, at a strategic level, it is clear that understanding and leveraging HC effectively includes focussing on the aforementioned attributes that were previously referred to as human resources. Ultimately, finding an effective way to record and report HC issues will help firms identify critical sources of value, which in turn should allow them to better manage their HC effectively to gain competitive advantage (Abhayawansa & Abeysekera, 2008; Hatch & Dyer, 2004; Ployhart, Nyberg, Reilly, & Maltarich, 2014; Russ, 2014).

As the developed world has moved away from an industrial to a service and knowledge-based economy, an increasing number of organisations will depend on HC assets, as opposed to physical assets, to add value to their services (Adler, 2001). From an accounting perspective, where the need for precise metrics is important, the measurement of HC has proved challenging, and some have argued that the lack of internationally accepted accounting standards for the disclosure of HC has undermined the credibility of corporate accounting reports (Eckstein, 2004; Khan & Khan, 2010). Kim and Taylor (2014: 66) state "this gap in reporting will eventually lead to an underfunding problem for knowledge intensive firms and, at the same time, create an information asymmetry problem for investors". Furthermore, Molloy and Barney (2015) believe that organisations need to be able to understand the issue of HC to assess the full value of their workforce. Therefore, the issue of HC reporting has not only become a key issue for organisations and shareholders, but also for potential investors and current and potential employees.

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With this in mind, many organisations have been voluntarily disclosing HC data in their annual reports by including narrative sections relating to HC strategy and performance metrics (Wisniewskia & Yekini, 2015). HC reporting studies have been undertaken in various countries around the world including Ireland, Canada, Sri Lanka, Australia, Bangladesh and Denmark (see Abeysekara & Guthrie, 2004; Brennan, 2001; Bontis, 2003; Khan & Khan, 2010; Nielsen, Roslender, & Schaper, 2016). Although HC reporting has been increasing in Scandinavia, Australia and some Pacific Rim countries, the UK has been lagging behind in comparison with its international competitors (Fincham & Roslender, 2003; Roslender et al., 2012).

However, more recently there have been a number of initiatives by industry bodies as well as government regulation to enhance HC narrative reporting in the UK, including statutory attempts to make HC disclosures mandatory. In particular, a number of amendments were made in 2013 to the Companies Act 2006 to provide better guidelines for reporting on progress towards addressing environmental issues, employee issues, such as diversity and human resource development, and social and community issues. The aim of this paper is to investigate the current state of HC reporting in the UK by analysing the annual reports of the Financial Times Stock Exchange (FTSE) 100 companies before and after the above amendments to the Companies Act 2006. The research also identifies best practice in HC reporting amongst the companies analysed.

The findings show that most of the FTSE 100 companies in the UK have been increasing their HC reporting, and are doing more than simply fulfilling their statutory duties in terms of reporting. The findings here are consistent with some of the findings from studies of HC in other countries, with the companies reporting strongly in areas of employee training, health and safety, career development and leadership (Abeysekara & Guthrie, 2004; Khan & Khan, 2010). The findings also show that companies are moving away from wider IC disclosures to focus more on human resources issues, which was particularly evident in the analysis of HC reporting best practice. However, it was also found that there are significant differences in the levels of reporting for certain HC items. Another key finding was that information relating to HC was placed in various sections of the annual report and that a wide variety of terms were used to describe essentially the same phenomenon. It is argued that companies should continue to enhance their narrative disclosures, but some form of standardisation might enhance the value to users of the annual report. A number of areas for further research are identified, including how HC could be better reported to benefit investors and employees, and the need to understand more fully why there are significant differences in the levels of HC reporting by certain companies.

The remainder of the paper is structured as follows. In the next section an overview of the literature related to HC reporting is provided before the methodology is outlined. This is followed by the research findings, and finally a discussion of the findings and suggestions for further research.

2. Human capital reporting literature review

2.1. Background to HC reporting

The origins of HC reporting date back as far as the early 1960s when Hermanson (1963) attempted to incorporate employees on a company's balance sheet. This was justified by arguing that human assets produced monetary value for an organisation in the same way as physical assets; moreover, Hermanson (1964) felt that these assets were not owned by the company, but were operational assets. For these reasons, Hermanson believed that such assets should be accounted for in financial statements; therefore the focus of his work was external reporting. Hekimian and Jones (1967) agreed that human assets should appear on a company's balance sheet, but also emphasised the importance of managers being aware of the value of their employees. In the 1970s, the subject of human resource accounting became an area of increasing academic interest; however by the end of this decade this had waned considerably (Roslender & Dyson, 1992). At the beginning of the 1970s, Flamholtz (1971) introduced the Stochastic Model of HC, which highlighted the value of the employee's contribution in the period they are employed as being important. However, authors such as Andrade and Sotomayor (2011) criticised this model, as they felt it failed to truly capture the fact that individuals who operate in a group may have a higher organisational value. Nonetheless, Flamholz was a very important figure with regard to accounting for the worth of employees and considered this issue from both a financial and managerial perspective. Accordingly, the financial reporting of human assets was important as it provides investors with information about the building and depletion of such assets; whereas from a managerial viewpoint, appreciating the value of employees would assist in recruitment, planning and operations (Flamholtz, 1974). However later, Flamholz (1975) felt that a fixation on reporting human assets externally was giving the false impression that human resource accounting was only concerned with treating people as financial objects and that, whilst important, external reporting was not the most significant aspect of human resource accounting. It was clear therefore, that he was beginning to place a greater emphasis on the managerial perspective; a standpoint that aligned with the focus of IC, which was never concerned with accounting for human assets on financial statements. Nevertheless, it could be argued that the failure to move beyond viewing HC as something that has to be given a financial valuation, has made the task of those advocating the importance of ascertaining the underlying value of employees more difficult.

The interest in IC began in the late 1980s and has continued to this day; although arguably this interest reached a peak in the 1990s and early 2000s. Initially IC was deemed to consist of organisational capital, customer capital and HC (Wall, Kirk, & Martin 2003), however these classifications have kept evolving (Tan, Plowman, & Hancock 2008; Massingham & Tam 2015); for example, Abeysekera and Guthrie (2005) retained the term HC but referred to structural (as opposed to organisational) and relational (as opposed to customer) capital. Nonetheless, there is no doubt that IC led to renewed efforts to account for, and report on, the value of HC (Nahapiet & Ghoshal, 1998; Roslender 2009). In this regard, Scandinavia led the way in HC reporting during the 1980s and 1990s with the introduction of IC and HC indicator models such as the Skandia Navigator, Ericsson's Cockpit Communicator, Celemi's Intangible Assets Monitor and Ramboll's Holistic Company model (Edvinsson & Malone, 1997; Wall et al., 2003). For example, the