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Annual Reporting Practices: Information about Human Resources in Corporate Annual Reports in Major Swedish Companies

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ABSTRACT

In this article the aim is to report from two empirical studies of annual reporting of intellectual capital (IC), with particular emphasis on human resources (HR) in Swedish companies. The studies were made on the largest Swedish companies on the stock market's A-list, during the years 1990, 1994 and 1998. The material used was the external annual reports. In the studies we wanted to assess the extent to which large companies are publicly reporting their IC. The research aimed to investigate the reporting practices in Swedish companies. The research question was to determine if company representatives' desire to make HR more transparent is merely an expression that is not supported by real conviction. The studies showed that there is a very low share of information disclosed about human resources in the corporate annual reports. A tendency to increase was evident, but it is, on average, below 4%. None of the 18 largest companies were above 7%, which reveals that there is a lack of good examples to be found in this group of companies and very little changes had taken place during the past 10 years. It must be concluded that a great deal is often said about the importance of having a more transparent HR or human capital in companies, but the evidence suggests that in the real world this is still not the case.

INTRODUCTION

In 1998, the largest Swedish corporations (>500 employees) invested nearly 79 billion Swedish Crowns (SEK) in intangible assets (R&D, marketing, software and system programmes) and around 40 billion SEK in tangible assets at current prices. This means that the intangible investments are two thirds of the total investments in Sweden.

The investments in intangibles in US business represent nearly as much as they do in plant and equipment, or around 1 trillion dollars (Nakamura, 2001). Such a dominating share indicates that the most important production factor of enterprises is intangibles. The value, which is capitalised on the stock market, is hidden in the books. The values are hidden in large as well in small companies.

According to Professor Baruch Lev (2000), the market-to-book ratio in the 500 biggest companies in the USA reached, on average, 6.25. This ratio indicates that in the USA intangibles account for six of seven dollars of corporate value. For high tech companies, this ratio is much higher.

In the USA, as well as in Europe and Australia, it is an intensive debate about the lack of information about "intangibles" in the annual external statements. An interesting reflection is what it means for the economy as such if we continue to conceal the intangibles. In the conference about Intangibles at Stern School of Economics, New York University in May
2001 it was stressed that the poor reports also probably meant an underestimation of the growth in economy.

The accounting system considers, in principal, only physical and tangible properties as real assets. The intangibles or intellectual capital (IC) represented by human capital, brands, licenses, systems, software, R&D expenditures and organisational capital are only accounted for as assets and visible when they have been part of a fusing process in which two or more companies merge. The huge sum of money spent on, for example, development of new technology, new software or marketing efforts is not visible as book value, at least not until the company could capitalise it by selling the company as a unit. Despite the obvious shift in economic reality, the management accounting field has not yet developed sufficient tools to record, measure and manage the value of IC (Flamholtz, 1999; Lev, 2000; Rundfeldt, 2000).

In the new standards, IAS 38, published by the International Accounting Standard Committee, it is stated that, concerning investments in intangibles, companies are obliged to disclose intangibles as assets under the following special conditions: (1) the intangibles are controlled by the company, (2) they are expected to generate revenues in the future, (3) if the company could be expected to be able to have an advantage of the return on the investments in these assets and (4) if the value could be evaluated in a confident way. Some intangibles are still not included in these new rules, such as internally generated goodwill, brands, licenses and customer databases (Rundfeldt, 2000).

Two American organisations have recently recommended improvements in financial reports. The most prestigious, the Financial Accounting Standards Board (FASB), has recently published two reports from its project about Business Reporting: (1) Improving business reporting: insights into enhancing voluntary disclosures and (2) Business and financial reporting, challenges from the new economy. Association for Investment management and research (AIMR) also have recently published their report that contains recommendations about improvements in financial reporting.

OECD has had a group working with questions on IC. The group arranged research projects and meetings with the aim to find ways to increase the transparency of human capital and IC in organisations.

During the last decades, the question of how to follow-up and value a company with no or very few tangible assets has come into focus. The problems have been very evident during the period of turbulence around IT companies - during the period 2000-2001. A way to get information about companies’ ability or capacity to generate future profit is probably by reading and analysing the text content in the annual statements or corporate reports. Do the reports and their content as such reflect the company policy? A question is if the companies’ intention has been implemented in the annual reports. An assumption made here is that the reports could be a way to identify and approximate the practice but do they tell anything about the real policy our the “policy in use?”

THE GOAL WITH ACCOUNTING

One of the main ideas with accounting is to give management, shareholders, analysers, investors, employees, society and stakeholders usable information. Accounting should help them to follow-up, analyse and make decisions and thus contribute to get an effective allocation of economic resources in the company. It means that both the content and the form of the information in the annual statements and reports are important.
According to international accounting standards, “Financial reporting should provide information that is useful to present to potential investors and creditors and other users in making rational investment, credit, and similar decisions” (FASB, Statement of Financial Accounting Concepts No. 1, November 1978, paragraph 34).

The value and usefulness for the stakeholders of the annual reports are probably higher if the reports would be adapted to the users and provide them with good service. According to FASB, to be usable it should be both relevant and reliable. It is relevant if it has an impact on the decisions; it is reliable if it is in accordance with reality, i.e. if what is described is in accordance with the companies’ reality.

The lack of information about intangibles and what it means both for the estimation of economic prosperity and for the possibility to reflect the real value of the company is evident. The need for change in the global accounting standards and practice is apparent. There seems to be a consensus among different stakeholders that something has to be done, but what?

THE IC MODEL

Leif Edvinsson has presented one model of defining IC (Edvinsson & Malone, 1997). According to Edvinsson’s model, IC consists of human capital and structural capital. Human capital includes the knowledge of the employees in an organisation as well as their creativeness; it also includes cultural patterns, traditions and values that exist in the company. A company cannot own its human capital, the employees and their competence and experiences.

Structural capital contains the company’s hardware, software and databases. Patents and trademarks also belong to this category. As stated by Edvinsson, structural capital is everything that is left in the office when the employees have left for the day. However, it can also include best practices and solutions that are handed over by the employees to new employees and not always documented in databases or elsewhere. Structural capital reinforces knowledge in order to multiply and re-use it. Exchanging knowledge and information among people as well as among entities are parts of structural capital. Through the sharing of knowledge, the organisation can quickly leverage the competence and skill of each individual as well as all the employees. Structural capital consists of customer capital and organisational capital. Customer capital comprises relationships with customers and introduces the customer base. It also contains the company’s potential to increase its customer base, i.e. networks with potential customers. Organisational capital consists of two parts: innovation capital and process capital. These components are the company’s capacity to keep up with changes taking place on the global market. To maintain the ability to change a company well functioning processes are needed, a process capital, to rapidly exchange knowledge within the company and a support system for enhancing continuous learning among the employees. The company’s innovation is dependent on the creativeness of its employees; to achieve this, the company has to maintain an atmosphere that supports novel ideas and new approaches to old issues. The latter is summed as innovation capital.

The focus in the Edvinsson model is to get a better understanding of the future cash flow that is dependent on the IC. IC consists of two parts: human capital and structural capital. The transformation of knowledge from human to hardware in structural capital or systems is dependent on the people in the company.
THE AIM OF THE ARTICLE

In the forthcoming material, we are primarily following-up as to what is said in the corporate annual reports about human capital. We use the expression Human Resource information (which is equal to HR information).

An assumption is that a company would disclose its personnel policy by how it records, measures and manages its human capital. Disclosure gives transparency and transparency gives the stakeholders information they need to predict the future value of IC from human capital. By reading about the way a company deals with its employees, it becomes possible to predict on its future success in the other IC factors. This is the basic assumption made in this study.

How much evidence is it possible to get from the corporate annual reports? What sort of information is most common? Are the annual reports the forum for disclosure of information about IC? What is the practice today and how did it developed over the past decade?

HR IN THE ANNUAL REPORTS

Those who are creating the corporate annual reports have to follow the legislation and the official rules for income statement, balance sheet and statement of cash flow. In addition to that, one can assume that the content of the report of directors generally follows the main stream among reports of directors.
Researchers often view annual reports as a means by which a corporation locates and identifies itself with various external and internal stakeholders (Gutherie & Petty, 2000).

An often foreseen fact is that the production of annual reports has its “own life” with special procedures. A study showed that the content of the reports is dependent on who creates the reports and the way in which the reports are produced (Wikenståhl & Lennartsson, 2001). The fact that the companies’ CEO in his speeches is talking a great deal about the new and competing HR policy does not necessarily imply that you can read about it in the annual report. The persons who are the authors and the heads behind the reports could be persons who are not doing the same valuation as the CEO of the information about HR. On one side, they could be interested in building a special image around the HR policy; on the other side, they could be afraid of “breaking with the old” and are influenced by the rules and official lines built during the past century for doing the annual reports.

Some studies have been made on the content of the annual reports. A recent study was done in Australia (Gutherie & Petty, 2000) on disclosure of IC in the 20 largest listed companies. Information was analysed with content analysis and the findings were codified according to Sveiby’s three categories: Internal structure (patents, concepts, R&D, computer systems, etc.), external structure (customer relationships, brand names, trade marks, etc.) and employee competence (education, skills, training, values, etc.). Both the amount and type of information were reported. Only the voluntary information was included in the content analysis. The findings showed that none of the companies had instituted systematised intellectual capital reporting frameworks. The type of attribute reported for each individual company appears fairly randomly distributed and there was no obvious trend found in the data. “The biggest challenge by far is establishing a consensus about the need to report,
what to report, and how to report on it”....“If and when consensus is reached, then the next major step is to either refine the reporting models or o develop new models” (Guthrie & Petty, 2000, p. 21).

Subbarao and Zeghal (1997) studied 120 annual reports between 1993 and 1994 from corporations in the USA, Canada, United Kingdom, Germany, Japan and South Korea. Using content analysis, they measured the following items: (a) training (training programs), (b) value added (strategy, statement), (c) equity issues (race, gender, employment equity, disabled), (d) employee relations (HR section, safety, union activity, employee numbers, etc.) and (e) compensation (benefits, pension, profit share, etc.) The most striking result was that most of the reports (or 98 of 120) analysed disclosed information on benefits. One third of the sample (40) referred to gender diversity on the board of directors. The text size disclosing information about human resources, measured as number of words, was biggest (around 2,000 words) in the USA, the UK, Germany and Canada. The word frequency was much less in Japan and South Korea, where it was around 500 words. Their conclusion was that the need of shareholders, employees and the public for information on human resources is required before a general legislation could be prepared.

THE METHODOLOGY USED TO IDENTIFY THE HR INFORMATION IN THE REFERRED STUDIES

This paper summarises the findings from two studies made under my supervision. Students made the analysis on two occasions: 1995 (Schriwer & Thynell) and 1999 (Blomqvist & Nilsson).

The two studies examined the extent to which large organisations are publicly reporting information about their human capital. Both studies used the same methodology and definitions. The corporate annual reports from 1990,1994 and 1998 of the 18 largest companies listed on the stock market were investigated. A standard token analysis and a content analysis were conducted. In the first study (Schriwer & Thynell, 1995) the annual reports from 1990 and 1994 were studied. In the second study (Blomqvist & Nilsson, 1999) a comparative study was made with Swedish, German and English annual reports from 1998.

In the token analysis the students counted the number of tokens (characters) that were printed in the corporate reports. First, the students had to decide which parts of the report were the general text and, second, they had to define what they wanted to count as “text about the personnel and HR questions.” In the next step they compared the relative number of personnel text with the total text in the annual reports. They excluded the following items from the number of tokens in the total report:

- Information about the companies stock
- Balance sheet and income statement
- Pictures and information about the board
- Auditing report
- Holding companies
- Cash-flow analysis
- Proposal for the distribution of profit
BIRGITTA OLSSON

- The cover pages
- Addresses and phone numbers
- Principles for valuation and accounting paragraphs
- Definitions of key ratios

In the study how much of what was written about human capital was counted. The compulsory text was excluded. The compulsory text to disclose HR information in Swedish corporate annual reports is the average number of employees in the past year, including information about the distribution between men and women. The information should be for the company as a whole and for entities with more than 20 employees. Compulsory information should also be disclosed about the salary in total as well as for the remuneration to the board.

The token analysis was completed by a content analysis on the material from the 1998 annual reports (Blomqvist & Nilsson, 1999). The categories for the content analysis were made according to five criteria:

- Education/development.
- Equality
- Recruitment
- Section about personnel/HR
- CEOs' comments about personnel

RESULTS

The study on the 18 companies on Stockholm stock market's A-list was done to find out the disclosure practices and if there had been any changes in disclosure practices among these big companies. The results of the study concerning the number of tokens (characters) used to describe HR or personnel in the corporate annual reports in Sweden for the years 1990, 1994 and 1998 are described in Table 1. The written text, on average, in Swedish companies' annual report is more extensive for the year 1998 than for the years 1990 or 1994. The increase between 1990 and 1994 was only 3,765 tokens or about two book pages of written text. However, between 1994 and 1998 a large increase was observed (33,312 tokens or almost 50%. The latter increase could be estimated to about 16-17 additional pages compared with 1994. The number of tokens used in the annual reports to give information about the personnel or HR was, on average, 1,556 characters in 1990, which could be compared with about one written book page and in 1994, it had increased 65%. Between the years 1990 and 1998 it more than doubled and the result was an additional two pages of HR information.

The total text mass increased 58.0% between 1990 and 1998 and the number of personnel tokens increased by as much as 138.6% (Table 2). The relative increase in share of personnel token was between 1990 and 1998 only 1.23%. We did not analyse the reasons underlying this increase in the total text mass, but a reasonable hypothesis could be that companies report on the ongoing integration to the European Monetary Union (EMU) and the impact it will have on the company.
Table 1. Token analysis. Number of characters found in corporate annual reports (Blomqvist & Nilsson, 1999).

<table>
<thead>
<tr>
<th>Company</th>
<th>Number of tokens totally</th>
<th>Number of personnel tokens</th>
<th>Relative share of personnel tokens (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABB</td>
<td>128656</td>
<td>90230</td>
<td>90357</td>
</tr>
<tr>
<td>Astra</td>
<td>67322</td>
<td>63690</td>
<td>85728</td>
</tr>
<tr>
<td>Atlas Copco</td>
<td>64675</td>
<td>50936</td>
<td>109134</td>
</tr>
<tr>
<td>Ericsson</td>
<td>48590</td>
<td>63659</td>
<td>139428</td>
</tr>
<tr>
<td>Gambro</td>
<td>69342</td>
<td>82575</td>
<td>112578</td>
</tr>
<tr>
<td>H&amp;M</td>
<td>17709</td>
<td>16893</td>
<td>28236</td>
</tr>
<tr>
<td>Modo</td>
<td>66876</td>
<td>59007</td>
<td>117165</td>
</tr>
<tr>
<td>SCA</td>
<td>59680</td>
<td>76071</td>
<td>172367</td>
</tr>
<tr>
<td>SEB</td>
<td>62152</td>
<td>73494</td>
<td>131273</td>
</tr>
<tr>
<td>SHB</td>
<td>37474</td>
<td>67114</td>
<td>100006</td>
</tr>
<tr>
<td>Skanda</td>
<td>79144</td>
<td>81288</td>
<td>67108</td>
</tr>
<tr>
<td>Skanska</td>
<td>83600</td>
<td>80928</td>
<td>87207</td>
</tr>
<tr>
<td>SKF</td>
<td>42200</td>
<td>35784</td>
<td>104085</td>
</tr>
<tr>
<td>SSAB</td>
<td>45150</td>
<td>56491</td>
<td>118442</td>
</tr>
<tr>
<td>Trelleborg</td>
<td>94325</td>
<td>76109</td>
<td>105033</td>
</tr>
<tr>
<td>Volvo</td>
<td>75264</td>
<td>81095</td>
<td>62422</td>
</tr>
<tr>
<td>Total</td>
<td>115000</td>
<td>121778</td>
<td>1817380</td>
</tr>
<tr>
<td>Mean</td>
<td>63889</td>
<td>67654</td>
<td>100966</td>
</tr>
</tbody>
</table>

The mean relative share of personnel tokens of the total text mass for 1990 was only 2.44 and increased to 3.77 tokens in 1994; finally, a slight decrease (mean 3.67) in the number of personnel tokens was observed in 1998 (Figure 3).
Figure 3. Disclosed HR information in 18 large Swedish companies in 1990, 1994 and 1998. The figure shows the relative share of text about HR in corporate annual reports.

Figure 4. The share of HR information in the corporate annual reports for 1990.
Figure 5. The share of HR information in the corporate annual reports for 1994.

Figure 6. The share of HR information in the corporate annual reports for 1998.
COMPANY PRACTICE

In the first studied year (i.e. 1990) two companies, Aga and SCA, did not disclose any information about HR, except for the compulsory information in their corporate reports. The second measure (i.e. 1994) revealed that Aga still did not disclose any HR information. SCA, however, had advanced to above average or 5.36%. The variance between companies ranged from 0 (Aga) to 10.41% (SKF). The third measure performed on the 1998 reports gave an indication that the trend of improvement from earlier years persisted and the variance was between 1.29% (Skandia) and 6.71% (Electrolux). The variance for Skandia demands an explanation. Why did we find that Skandia was in the bottom? It is of course a bit misleading to just study the corporate annual report from Skandia because they also published a special report on IC and even published it on a CD medium as well. These procedures, however, are not reflected in the annual report from Skandia. Half of the companies (Electrolux, Astra, Atlas Copco, Modo, SCA, SHB, Skanska, Volvo and SSAB) disclosed HR information above the average (3.67%). The company that disclosed the fewest number of tokens (or 518) was H&M.

Figure 7. HR information in comparison with total information in 18 Swedish companies' corporate annual reports for the years 1990, 1994 and 1998.

CONTENT ANALYSIS

The second group of students carried out the content analysis on the annual reports from 1998 (Blomqvist & Nilsson, 1999). According to the criteria used in the analysis, the most common content was education and training, which was mentioned by the companies except
ANNUAL REPORTING PRACTICES

one. All the companies, except for Atlas Copco, had special paragraphs where they disclosed HR information. Questions about equality were mentioned only by 4 of the 18 companies. Strategies for recruitment were made reference to by 11 of the 18 companies. The companies also discussed difficulties in finding personnel with the “right” education and background.

Table 3. Content analysis on corporate annual reports from the 18 largest Swedish companies, 1998 (Blomqvist & Nilsson, 1999).

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Education/training</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Equality</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Recruitment</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Section about personnel/HR</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>CEOs’ comments on personnel</td>
<td>x</td>
<td></td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

COMPARISON OF SWEDISH PRACTICE WITH ENGLISH AND GERMAN PRACTICE

One question of concern is whether there are any differences in the reporting practice between countries. In the 1998 material (Blomqvist & Nilsson, 1999) a comparative study was also made in which the Swedish material was compared with material from similar companies in England and Germany. The material from Germany and England was collected from the corporate annual reports from the 10 largest companies in each country. The results indicated that the English companies divulged as the least amount of HR information of the total text mass (2.77%); Swedish companies disclosed somewhat more HR information (3.77%) and Germany disclosed the most HR information (5.20%). Consequently, there are very small differences between the reporting practices in the studied companies from three European countries. The conclusion is that the reporting practices are very deficient in the quality or extent of the material disclosed, independent of which country (i.e. Sweden, England or Germany) is studied.

<table>
<thead>
<tr>
<th></th>
<th>HR information (Total number of tokens)</th>
<th>HR information (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sweden</td>
<td>3702</td>
<td>3.77</td>
</tr>
<tr>
<td>Germany</td>
<td>5319</td>
<td>5.2</td>
</tr>
<tr>
<td>England</td>
<td>2431</td>
<td>2.08</td>
</tr>
<tr>
<td>Mean</td>
<td>3817</td>
<td>3.58</td>
</tr>
</tbody>
</table>

CONCLUSION

The results of the token and content analysis focus purely on the voluntary information not required by an accounting standard or the law. The assumption was that disclosure of HR information on a voluntary basis could be a token that the company was more aware of the importance of being careful about the IC.

None of the 18 largest companies disclosed more than 7.0% of HR information as a share of the total information in the annual reports in 1998. This finding reveals a lack of good examples in this group of companies. Very little meaningful changes had taken place during the past 10 years. It must be concluded that a good deal of what was said about the importance of disclosing HR information or having greater transparency regarding a company’s human capital is largely lip service and not in accordance with reality. We have not investigated the full arsenal of IC factors in the two studies described in this paper, but we proved that the human capital factor so far is not more transparent today than it was in the beginning of the 1990s, even if the tendency is to have a more open accounting system for human capital information.

The findings as such do not reveal anything about the real policy of companies. We could not conclude that what is written in the reports is the actual policy that the companies practice. It is, however, assumed to be the only explicit evidence of practice available for the stakeholders in general. Another shortcoming of interpreting data from annual reports is that we could imagine that underlying every report it is a special team and a special creating process that is not necessary linked to those who think about and formulate the methods of content and the strategies for the future of the annual reports.

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*Measures that matter*, Ernst &Young LLP, 1999.


