Human Capital
- Explanations for voluntary disclosure of human capital in annual reports

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Abstract

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Title: Human Capital – *Explanations for voluntary disclosure of human capital in annual reports*

Background: Nowadays, many corporations claim that their employees are the company’s most valuable resource. Therefore, it may seem odd that most companies choose not to disclose much voluntary information concerning human capital in their annual reports, even though most agree that their employees contribute to the company’s competitive advantage. Especially knowledge-based companies, whose core assets are not shown on the balance sheet, are expected to have incentives for wanting to disclose information concerning human capital in their annual reports.

Purpose: The purpose of this study is to identify and discuss the explanations behind why knowledge-based companies, with focus on three well-known Swedish auditing firms, choose to disclose voluntary information on human capital in their annual reports of 2010/2011, and to see if the explanations vary with company size.

Methodology: This bachelor thesis has been conducted as a comparative case study of one relatively smaller and two relatively larger companies in the auditing industry. The case study has been qualitative and the empirical findings have been collected through semi-structured interviews with the participating companies.

Findings: We find that auditing firms provide several explanations for their human capital disclosure. All of the companies claim that one explanation for this disclosure is that it enables them to show that their employees are such an important resource for the business and for the company’s survival. They also explain that human capital disclosure enables them to show their employees that the company cares about them. Further, they explain that human capital disclosure increases their trustworthiness. From these explanations, we can see that all of the companies address their human capital information to different stakeholders. Moreover, we find that the companies’ explanations do not vary with company size.

Suggestions to future studies: Future studies could choose to repeat this study but focus on another knowledge-intensive industry, and the results could then be compared to those of this bachelor thesis. It could also be interesting to do a comparative study between auditing firms in different countries on why they disclose voluntary information on human capital.

Keywords: Human capital, voluntary disclosure, annual report disclosure, auditing firms, explanations.
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The process of writing this thesis has been a rollercoaster with a lot of ups and downs, and we would like to thank each other for the ability to cheer each other up and make each other laugh. Finally, we would like to give a special thanks to Loreen, the Winner of Eurovision Song Contest 2012, for making our last weekend of writing a bit more endurable!

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Hanna Johansson  
Sofie Karlsson
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Chapter One: Introduction

In this first chapter, we will introduce the subject of human capital and briefly describe the historical developments in the field, as well as provide a problem discussion. This will then lead on to the research questions and purpose of this study. Further, the key words will be defined and finally a disposition of the thesis will be provided.

1.1 Background and problem discussion

“Companies that ignore human capital will go the way of dinosaurs” and “human capital is the coming competitive advantage in the modern knowledge economy, and measuring and reporting human capital is essential to building sustainable economic success.”


“With physical and financial capital having been replaced by human capital as the economy’s driving force, the knowledge, skills and experience of people have become this country’s scarce resource.”

- Lowell Milken, 2012, Milken Family Foundation Chairman and Co-Founder

As suggested by the quotes mentioned above, human capital is important for the economy, and hence it is increasingly essential that companies consider their employees as an important resource. A further indication of the importance of human capital is that the interest of companies to disclose voluntary information on human capital has increased in recent decades. According to Flamholtz, Bullen and Hua (2002) the interest for human resource accounting grew significantly during the 1970’s and it was around this time that the idea of showing the employees on the balance sheet began. Several researchers have tried to implement this idea, but none have succeeded due to the fact that one of the criteria that defines an asset is that it must be controlled by the company (Smith, 2006). However, an employee can choose to leave the company whenever they want, which makes the mentioned criteria unfilled. One exception is professional sport clubs that are allowed to activate their players on the balance sheet, by the sum of the transfer fee, and write off the sum during the player’s contractual period (Catasús & Nobrand, 2011). During the 1980’s several new companies emerged on the market that all had a strong focus on knowledge and skills, so-called knowledge-based companies (Rimmel, 2003). These companies’ core assets are intangible, such as human capital and intellectual property, and are not shown on the balance sheet (Flamholtz, Bullen and Hua, 2002). Among knowledge-based companies, the expression intellectual capital became frequently used during the 1990’s especially when markets started to observe a significant gap between market values and book values (Rimmel, 2003). Edvinsson (1997) has developed a model, The Skandia Navigator, in order to explain this gap. The model consists of five focus areas (financial focus, customer focus, process focus, renewal and development focus, and human focus) that strive to explain what a
company’s entire market value consists of. The idea of the model is that market value consists of book value together with intellectual capital (Edvinsson and Malone, 1997). As this historical review suggests, the view on how to disclose information about one of the company’s core assets has changed over time. It is nowadays increasingly important for companies not only to care about their employees but also to show this to their stakeholders.

Intellectual capital can, according to the European Intellectual Capital Statement (ICS) Guideline, be divided into three main categories: human capital, structural capital and relational capital. The focus of this study will be on human capital, which Abeysekera and Guthrie (2004, p. 253) define as “... a combination of factors possessed by individuals and the collective workforce of a firm. It can encompass knowledge, skills and technical ability; personal traits such as intelligence, energy, attitude, reliability, commitment; ability to learn, including aptitude, imagination and creativity; desire to share information, participate in a team and focus on the goals of the organization.” This definition is in compliance with our view on human capital, and we especially appreciate that it includes both the individual’s own capabilities and what they can accomplish together as a team.

Sveiby was one of the first researchers to suggest that companies could provide voluntary external disclosure on human capital (Annell & Sveiby, 1989). This was the starting point, and since then the interest has increased on disclosing voluntary non-financial information. There are different ways to disclose the information about human capital, either by disclosing it directly in the annual report or as a separate complementary document (Abhayawansa & Abeysekera, 2008). There are several arguments why companies choose to disclose voluntary information in their annual reports, as opposed to other media. One argument is that the annual report is broadly dispersed and that it is a main media of communication to the company’s stakeholders. It is also a media where the company has considerable freedom to choose what voluntary information is published to the public (Ax & Marton, 2008). In contrast to this, the annual report is also a document that has been criticized. Some argue that in today’s rapidly changing environment investors are increasingly reliant on other medias, such as firms’ web sites, for information that might facilitate their decision-making. The accessibility for more timely information has made investors less reliant on annual reports (Souissi & Khelif, 2012; Lev & Zarowin, 1999). In addition to this, studies have shown that there is a significant difference between what information the market demands and what is actually disclosed in annual reports (Bukh et al, 2005). Another criticism leveled at annual reports is the fact that it is a document that is costly to produce and that the financial statements do not reflect some of the intangible assets that contribute to prosperity, such as intellectual capital and human resources (Ax & Marton, 2008; Wallman, 1996). In this study we will focus on the voluntary information on human capital disclosed directly in annual reports since this is a document that all larger companies supply.

Many corporations claim that their employees are the company’s most valuable resource. Therefore, it may seem odd that most companies choose not to disclose much voluntary information concerning human capital in their annual reports even though most agree that their employees contribute to the company’s competitive advantage. We believe that knowledge-based companies would have more incentives to disclose their personnel than industrial companies, due to the fact that the employees perform services that require a greater amount of specific expertise and skills. The companies need to employ well-educated people and maintain their knowledge by providing continuous education in order to be able to offer good services. The costs for keeping
the employees up to date can be substantial and we therefore believe that it would be a good idea to show what these costs consist of, for example to see that the employees are frequently participating in different educational courses. To conclude, we believe that if a company shows that it invests in their employees, it will retain and attract skilled employees, which will give the company a competitive advantage.

Ax and Marton (2008) wrote a scientific article about human capital disclosures and management practices. The research was conducted by collecting data from annual reports and e-mail questionnaires, and the authors suggest that future research could be more qualitative and include interviews about companies’ disclosure rationale (Ax & Marton, 2008). This article, written by two contributors to the field, inspired us to do a more qualitative piece of research where interviews will be one of the main methods for collecting data. We hope that this thesis can contribute to the field, which mostly has focused on what kind of information companies choose to disclose and how they choose to disclose it. With this thesis we contribute to explain why companies choose to disclose voluntary information concerning human capital. According to Beattie & Smith (2010) and several other researchers in the field, there are numerous advantages and disadvantages to disclose human capital information. Examples of advantages are enhanced transparency and increased trustworthiness, and a disadvantage is that the company gives away information that their competitors might gain from (Beattie & Smith, 2010). We want to identify whether the companies that we have chosen to interview give similar explanations for choosing to show or not to show this information, or whether they might have other explanations for doing so.

By conducting this study, the interviewed companies will have to contemplate what they include in their annual reports. By having to reflect on the reasons behind disclosing certain information, the companies might find that there are aspects to improve. Furthermore, other companies might also benefit from the study, since they can reflect on their own disclosure of human capital information. Reading our study could make companies more aware of the reasons behind the decision to provide voluntary information and inspire them to reflect on their own disclosure.

1.2 Research questions
To be able to identify and discuss why companies, with focus on one relatively smaller and two relatively larger auditing firms, choose to disclose voluntary information concerning human capital we have constructed one main research question that is followed up by one additional question.

• What types of explanations do auditing firms use for the disclosure of voluntary information concerning human capital in their annual reports?
  
  o Does the smaller company give similar and/or different explanations compared to the larger companies?

1.3 Purpose
The purpose of this study is to identify and discuss the explanations behind why knowledge-based companies, with focus on three well-known Swedish auditing firms, choose to disclose voluntary information on human capital in their annual reports of 2010/2011, and to see if the explanations vary with company size.
## 1.4 Definitions

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
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<tbody>
<tr>
<td>CA</td>
<td>Chief of Administration.</td>
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<tr>
<td>CFO</td>
<td>Chief Financial Officer.</td>
</tr>
<tr>
<td>COO</td>
<td>Chief Operating Officer.</td>
</tr>
<tr>
<td>ÅRL</td>
<td>The Swedish Annual Accounts Act, Årsredovisningslagen.</td>
</tr>
<tr>
<td>Auditing firm</td>
<td>A firm that provides accounting and auditing services for a charge.</td>
</tr>
<tr>
<td>Disclosure</td>
<td>The information concerning human capital that a company chooses to include in the annual report.</td>
</tr>
<tr>
<td>Explanations</td>
<td>The reasons that the auditing firms in our study provide for their voluntary disclosure of human capital.</td>
</tr>
<tr>
<td>Human capital</td>
<td>“HC refers to a combination of factors possessed by individuals and the collective workforce of a firm. It can encompass knowledge, skills and technical ability; personal traits such as intelligence, energy, attitude, reliability, commitment; ability to learn, including aptitude, imagination and creativity; desire to share information, participate in a team and focus on the goals of the organization.” (Abeysekera and Guthrie, 2004, p. 253)</td>
</tr>
<tr>
<td>Intellectual capital</td>
<td>“The possession of the knowledge, applied experience, organizational technology, customer relationships and professional skills that provide <em>Skandia</em> with a competitive edge in the market.” (Edvinsson, 1997, p. 44)</td>
</tr>
<tr>
<td>Mandatory information</td>
<td>The information concerning human capital that is required to disclose in the annual report according to the Swedish Annual Accounts Act.</td>
</tr>
<tr>
<td>Voluntary information</td>
<td>All information concerning human capital that is disclosed in the annual report besides the mandatory information required by Swedish law.</td>
</tr>
</tbody>
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1.5 Disposition

In this first chapter, a background and problem discussion will be provided, followed by this thesis research questions and purpose.

Previous Research

In this second chapter, an overview of the previous research will be presented.

Methodology

In this third chapter, a detailed description of the methodology used in this study will be provided.

Frame of References

In this fourth chapter, the relevant theories for this thesis will be presented, followed by a description of the standards and regulations in the field.

Empirical Findings

In this fifth chapter, the results from each of the three interviews will be provided.

Analysis

In this sixth chapter, an analysis will be presented, where the empirical findings will be connected to the frame of reference and previous research.

Conclusion

In this seventh chapter, an empirical conclusion and concluding remarks will be provided.

Final Discussion

In this final chapter, a general discussion will be provided, followed by suggestions to future studies.
Chapter Two: Previous Research

In this second chapter, we will present an overview of the previous research conducted in the field. This will include a description of the studies and their results, followed by a summary of the observed advantages and disadvantages with voluntary disclosure of human capital information.

As mentioned in the introduction, the subject of human capital has been debated for decades and several studies have been made about companies’ disclosure policies. In 2003, a doctoral thesis by Rimmel was published on the subject where he conducted a comparative study between the two insurance companies Skandia from Sweden and Allianz from Germany. The aim of the study was to compare whether the practice of disclosing voluntary information on human resources varied between the two companies. He found that both companies disclosed a substantial amount of voluntary information and that the amount depended more on disclosure strategy than on the company’s experience with annual report disclosure. The research shows that that the companies consider human capital disclosure to be important since it illustrates and improves the overall impression of the companies (Rimmel, 2003). Ax and Marton (2008) wrote a scientific article called Human Capital Disclosures and Management Practices where they studied the link between management practices and annual report disclosure. The study involved 16 Swedish companies listed on the Stockholm Stock Exchange and was conducted by data from both annual reports and e-mail questionnaires. Like in many other studies on the subject, the authors’ focus on the quantity of human capital disclosure, where information on, for example, number of words/sentences and existence of monetary data were collected from annual reports. The e-mail questionnaires were sent out to the CFOs’ of the companies selected and they were asked to rate the importance of numerous items. The authors then measured the correlation between what is deemed important by the CFOs’ and what is actually disclosed in annual reports. The results show limited correlation (Ax & Marton, 2008). In 2009, Brüggen, Vergauwen and Dao investigated the reasons for intellectual capital disclosure. Data was collected from the annual reports of 125 Australian companies, all publicly listed. They found that both firm size and industry type are two important factors for intellectual capital disclosure. Furthermore, and in contrast with earlier studies, they did not find a connection between information asymmetry and the level of intellectual capital disclosure. In the article Human capital, value creation and disclosure Beattie and Smith (2010) examined whether human capital contributes to value creation and also investigated external disclosure of human capital. The method used for the study was a questionnaire survey that was sent out to human resource directors, all working in United Kingdom listed firms. The answers were then compared to those of a previous study, made with financial directors. Concerning external disclosure of human capital, which is the focus of this study, the authors found that disclosing this kind of information is an important recruitment tool. However, they also found that external disclosure of human capital could harm competitive advantage. As seen, human capital disclosure in annual reports is a subject that have been broadly examined by using content analysis and surveys. By conducting this study, we hope to do a more qualitative piece of research on why companies disclose voluntary information about human capital, where interviews will be our main method.
Previous research implies that out of the three components of intellectual capital, human capital is the least disclosed (Abhayawansa & Abeysekera, 2008). In order to explain this non-disclosure of human capital Samudhram, Sivalingam and Shanmugam (2010) conducted a study where they analyzed the reasoning from different theoretical perspectives. They found three different reasons behind non-disclosure of human capital. The first argument is that demand is low since users do not see the strategic importance of the information and the other arguments are fear of giving away information to competitors and labor. Other studies have shown that most companies choose to only disclose information on human capital that is positive for the company, while they choose to not disclose information that could be negative for the company in the eyes of their different stakeholders (Williams, 2001).

In this section, a summary will be provided of what previous researchers have found as advantages and disadvantages with voluntary disclosure of human capital. Some of the advantages of this disclosure are that it implies trustworthiness with employees and other stakeholders, and it can serve as an important marketing tool (Beattie & Smith 2010). Further, the disclosure increases the transparency to capital markets, reduces the cost of capital, enhances corporate image (Alvarez Dominguez 2011), and reduces the information asymmetry (Brüggen et al., 2009) etc. The key incentive for external disclosure is to retain and attract employees with high competence. Other incentives are to motivate the employees, to inform external stakeholders of the managers’ competence, to establish good relations with the government and to enhance the likelihood of future prospects (Beattie & Smith, 2010). Some disadvantages of this disclosure are costs of providing the information, the risk of losing the competitive position (Curado et al., 2011), and the risk that the information is misinterpreted by external stakeholders, such as employees and labor unions (Samudhram et al., 2010), etc. To conclude, the benefits are assumed to exceed the costs when a company chooses to disclose voluntary information (García-Meca et al., 2005).
Chapter Three: Methodology

In this third chapter, we will describe the methodology used in order to conduct this study. We will start by discussing the choice of subject, selection of companies and the level of confidentiality. Further, we will discuss our collection and processing of data, which first and foremost was collected from interviews.

3.1 Choice of subject
The interest for human capital disclosure has increased in recent decades, and during this time there has been continuous discussions regarding the possibility to activate the employees on the balance sheet. The fact that professional sport clubs, such as football clubs, are allowed to activate their players on the balance sheet is what first caught our attention and made us interested to learn more about the field. However, as we learned more about the topic, we realized that a lot of research already had been conducted concerning the possibility to activate the employees on the balance sheet and we believed that we would not be able to contribute to any new findings. Since we were still very interested in the subject of human capital, we continued to read scientific articles related to the field. We found that a lot of quantitative research had been done on human capital disclosure in annual reports, but that it was significantly fewer qualitative studies conducted regarding this. Hence, we decided that our study was to focus on the explanations for voluntary disclosure of human capital in annual reports.

3.2 Research method
This bachelor thesis is a qualitative study of why auditing firms choose to disclose voluntary information on human capital. We have chosen to conduct this thesis as a comparative case study, since it is an appropriate way to gain the insight needed to answer our research questions. The method also gives us a perception of the respondent’s interpretations and thoughts (Merriam, 1994), which a different method, such as surveys, would not have supplied. To collect our empirical data we have interviewed three auditing firms and the choice to focus on auditing firms was made due to the fact that these are knowledge-based companies, which core assets are the employees. We settled on three companies since we believed that this would enhance the chances of more explanations and since multiple-cases allow us to find both similarities and differences between the companies. Furthermore, we used both scientific articles and books to gather the necessary information for our background, previous research and frame of reference. Moreover, we chose to solely focus on human capital disclosure in annual reports and not in other documents, such as transparency reports or corporate social responsibility reports.

3.3 Selection of companies and respondents
In order to answer our research questions, we have interviewed three auditing firms in Sweden regarding why they disclose voluntary information on human capital in their annual reports. The decision to interview three Swedish auditing firms was based on several reasons. Firstly, as mentioned above, auditing firms were chosen due to the fact that they are knowledge-based and that their core assets are human capital. Secondly, we chose Swedish firms since Sweden has been known for a high level of disclosure (Ax & Marton, 2008). Thirdly, with three companies we hope to receive a broader range of explanations from the companies than if only two firms
were interviewed. Fourthly, we settled on two larger firms and one smaller, since larger firms are considered more likely to disclose more information than smaller ones (Abeysekera & Guthrie, 2005), and we wanted to see if the companies’ explanations for their human capital disclosure were similar or differed. We have decided to use the number of employees as the determinant for classifying which companies are larger and which are smaller. We believe that this classification is appropriate since this study focus on human capital, which the employees are a part of. Moreover, since two relatively smaller and four relatively larger firms dominate the auditing industry in Sweden, we consider our selection of companies to be representative. Considering these aspects, we approached the chosen companies by contacting their respective student contact at University of Gothenburg – School of Business, Economics and Law. Our request was to interview a person that was involved in the process of producing the annual report and therefore, hopefully, had the necessary knowledge to be able to answer our questions. The student contact then guided us to the right person within the company, with whom we decided a date for the interview. We are aware that our choice of companies might affect the empirical findings, and hence the results. However, we are pleased with the final three companies and consider them to be representative of the auditing industry since we have managed to interview both smaller and larger companies.

Furthermore, we feel that it is worth mentioning that it has not always been easy to get hold of the needed respondents. Since we wanted to interview someone that was involved in the process of producing the annual report, we needed to interview a person within the top management of the companies. These persons are obviously very busy, which often made them difficult to get hold of. Fortunately, we finally managed to conduct all of our interviews, but we still want to mention the difficulty with aiming to interview someone in a high position, and hope that this can serve as a piece of advice for future students.

3.4 Confidentiality
In the beginning of this bachelor thesis, before we contacted the selected companies, we had to decide whether we wanted to keep the identities of the interviewed companies confidential or not. Keeping their identities confidential signifies that we are the only ones who know which companies we have interviewed, as opposed to anonymity, which would signify that no one, not even us, knew who the respondents were. Literature on the subject accentuates the importance of confidentiality and that it is a matter of protecting the integrity of the individuals. It also discusses the fact that confidentiality might affect the results of the study, since the results depend on the respondent’s willingness to answer the questions (Patel & Davidson, 2011). For us, the main advantage with confidentiality is that it might affect our results in a positive way, that the companies with the knowledge that their names will not be disclosed will give us more honest answers to our questions. However, we also realized that confidentiality would have its disadvantages. It would, for example, make it harder for us to describe the companies, the interviewees and their answers since details concerning their strategies or disclosure of their key values could easily expose their identities. After careful consideration, we found that the advantages with confidentiality outweighed the disadvantages and we therefore decided to conceal the identities of the interviewed companies. Nevertheless, we chose to name the companies after their size since we believed this would facilitate the reading of the thesis and we also chose to disclose the interviewees’ titles since we felt it would enhance the credibility of the study. The companies and the persons that we chose to interview were all aware of the fact that
their identities would be confidential, which we hope have affected their answers to our questions.

3.5 Data collection

3.5.1 Interviews
As mentioned earlier, our request was to interview persons that were involved in the process of producing the annual report, which we managed to do. All our interviewees worked as either CA’s (Chief of Administration), COO’s (Chief Operating Officer) or CFO’s (Chief Financial Officer) at their respective companies, and therefore all were involved in the process of producing the annual report. We believe that these respondents have the relevant knowledge and experience to be able to answer our questions. The fact that all of the respondents have similar titles makes their answers more comparable than if we would have interviewed one CFO and one Human Resource-manager. For our study, there were two appropriate ways of conducting the interviews, either face-to-face or by telephone. Face-to-face interviews were our top priority, since they provide a more personal meeting and enable you to notice facial expressions and body language etc. However, as a result of the long distance between some of the respondents and us, we have also conducted two interviews by telephone. When using telephone interviews there is a lack of non-verbal feedback, which requires the interviewers to be more attentive to the respondent’s answers (Kvale, 1996). Being aware of the drawbacks of telephone interviews, we tried not to interrupt the respondents and let them finish what they had to say before moving on to the next question. Worth mentioning is the fact that one of our scheduled telephone-interviews unfortunately had to be postponed due to other engagements for the respondent. We then offered the respondent the possibility to answer the questions by e-mail, which the respondent did. However, we felt that we needed more detailed answers to some of the questions and we managed to conduct a telephone interview with the respondent in order to complete the interview. Considering the circumstances, we are pleased with how everything turned out in the end.

There are both strengths and weaknesses with using interviews as a method for data collection. One strength with interviews is that it is a suitable way to obtain information about the respondent’s thoughts, feelings and experiences (Dalen, 2007). An additional strength is that it allows the interviewers to ask questions that are directly related to the subject. Potential weaknesses with the interview-method are errors made because of bad memory, bias as a result of poorly expressed questions and the risk that the respondents give the answers that they think that the interviewer wants (Yin, 2003). We conducted semi-structured interviews with the chosen companies’, which means that an interview guide was used. Semi-structured interviews are based on a certain set of questions included in the interview guide, but allow for additional questions to be raised during the interview in order to follow up for example uncertainties (Cachia & Millward, 2011). The interview guide that we used during the interviews, which is attached as Appendix 1, included questions that we had thoroughly designed in advance and practiced. The questions had been tested both on a friend of ours and on our tutor prior to the interviews and from these tests we obtained important insight on our questions that we considered when we modified the interview guide. The final interview guide was initiated with general questions regarding the respondent’s academic and professional background, as well as the respondent’s position at the company. We then moved on to more specific questions that aimed to give answers to our purpose and research questions. Finally, the interview was rounded off by some
additional questions. Moreover, in order to enable the respondents to speak their mind and not to restrict their answers, the final interview guide included open-ended questions. Furthermore, no leading questions were used, since these, when not deliberately used, can influence the respondent’s answers and might jeopardize the reliability of the answers (Kvale, 1996). As a result of these measures, we have tried our best to eliminate bias due to poorly expressed questions.

When the interview guide was finished we e-mailed the main questions to the respondents, in order for them to be able to prepare prior to the interview. Both of us were present at the interviews and one of us asked the questions while the other took notes on a computer. The interviews were centered on the interview guide, but when necessary additional questions were asked to better understand the respondents’ answers. Before the interviews began, we asked for the respondents’ approval to record the interviews, which all of them agreed to. When a recorder is used, there is a risk that the interviewees become troubled and inhibited (Trost, 2005), but we did not perceive any signs of this during our interviews. We used two recorders, and after the interviews we both transcribed them in order to complete the notes and to make sure that we did not miss any important information. We chose this method since it contributes to the avoidance of misinterpretations and is assumed to provide better data quality than if only our memories from the interview were used (Kvale, 1996). However, the transcribing process is very time-consuming, which is a drawback of this method.

The face-to-face interview was held at a place of the respondent’s choice in a calm and relaxed environment, and it lasted approximately one hour, while the interviews conducted by telephone lasted approximately 30 minutes. All of the interviews were conducted in Swedish and all respondents were asked if we could contact them after the interview in case of additional questions, which all agreed on. To conclude, we have attempted to take the necessary measures in order to make this thesis as objective as possible. We are aware of the risk that the respondents might give us the answers that they think we are looking for, and we have taken this into consideration when analyzing our empirical findings. For our study, when trying to identify possible explanations for human capital disclosure, we find that the strengths with using interviews as a method outweigh the weaknesses.

### 3.5.2 Data gathered by others

Initially, we read books and scientific articles in order to collect fundamental information and become acquainted with the subject of human capital. In the beginning of the bachelor thesis we also attended a lecture on information retrieval, organized by the Gothenburg University Library, which helped us become familiar with its databases. The literature and the scientific articles were then found by searching in these different databases, of which we found Business Source Premier, Emerald Management Xtra Plus, LIBRIS webbsök and Summon Supersök most useful. We have also used the Internet in order to find useful material, first and foremost Google. Some of the search words that we have used are: human capital, intellectual capital, voluntary disclosure, human resource accounting and annual reports. By combining these words in different combinations we have found relevant literature and scientific articles for our study, of which most of the articles were derived from scientific journals, such as Journal of Human Resource Costing & Accounting and Journal of Intellectual Capital. When searching in Business Source Premier and combining the search words human capital, disclosure and annual report...
and choosing only peer-reviewed articles we obtained 13 results. One of these results was *Human capital reporting in a developing nation* by Abeysekera & Guthrie (2004) that had 91 cited references, which caught our attention. If an article is peer-reviewed the quality of the article has been checked before publication.

The chosen scientific articles and books have been used as a basis for our background, previous research, and frame of reference. Furthermore, we have used the selected companies’ annual reports to gather information about the firms and as help for constructing the interview guide. The annual reports were collected, first and foremost, from the companies’ websites and when not accessible there we used the database *Retriever bolagsinfo* as a way of obtaining the report. Collection of the other data was gathered by using both systematic search and chain search. Our main approach has been the chain search where we have found appropriate literature by starting to read one scientific article, and then proceed to other articles and books that the first article referred to. An advantage with this search-method is that it, most of the time, guides you from one good reference to another, while a disadvantage is that you, by using this method, can fail to find other perspectives and arguments related to the subject. Alongside the use of the chain search we have also used a systematic search where we have combined the earlier mentioned search words in the relevant databases that the University of Gothenburg provides (Rienecker & Stray Jørgensen, 2008). All of the articles that we first started reading have been published between the year of 2005 and present day. The reason that some of our references might seem old is that we have found older literature that we feel cannot be excluded in order to present the subject in a rightful way. Another reason for this is that we, when possible, have tried to follow the arguments back to their original sources.

In conclusion, we have found the chain method useful when searching for scientific articles related to the subject. Moreover, the method has guided us to articles that have focused on the subject from different perspectives, which have given us a broad overview of the field. We chose to use the mentioned search methods since they facilitated our search for useful and relevant articles. Additionally, we have thoroughly selected the articles, on the basis of the publication year and the number of cited references, in order to secure their relevance and timeliness.

### 3.6 Analysis of the interview guide

As mentioned above, we conducted semi-structured interviews with the selected companies, which means that an interview guide was used. The interview guide included questions that were thoroughly designed to enable us to answer our research questions and fulfill our purpose. When designing the interview guide, we constantly tried to connect the possible parts of the frame of reference and previous research to our interview questions, in order to maintain the main thread throughout the thesis. For example, when writing the sections about the theories of isomorphism and legitimacy we saw a possible connection to the question concerning why the companies choose to disclose voluntary information on human capital in their annual reports. Another example concerns our previous research that naturally could be connected to our question regarding the perceived advantages and disadvantages of human capital disclosure. By carefully considering these connections, we early on had to reflect on the link between the frame of reference and empirical findings, which later on facilitated the analysis.
3.7 Data analysis
When processing the gathered material, we began by transcribing the interviews. In order to increase the credibility we both transcribed all of the interviews and then together summarized the answers under three main categories, namely *Thoughts on human capital, Why the company chooses to disclose voluntary information on human capital in their annual reports* and *Perceived advantages and disadvantages with human capital disclosures*. We are aware of the fact that our summaries of the interviews might have been influenced by our own interpretations, and to avoid misinterpretations we e-mailed the summaries back to the respective interviewee. This enabled the interviewees to check that we had perceived everything they had said correctly, and also gave them the possibility to give suggestions for changes. Subsequently, we considered the interviewees’ thoughts and comments with critical eyes, and thereafter made the changes that we considered necessary. By taking these preventive measures, we believe that the validity of our empirical findings has increased. When the mentioned steps were completed, we began to identify similarities and differences between all of the interviews and began to identify possible answers to our purpose and research questions. When writing the analysis and conclusion, we continuously returned to the frame of reference, previous research, and empirical findings, to secure that our analysis could be supported by prior sections of this thesis. Further, we have strived to be critical to the interviewees’ answers, and not to take their answers as the definite truth.
Chapter Four: Frame of Reference

In this fourth chapter, we will start by introducing the relevant theories for this thesis and then continue on with a section concerning standards and human capital reporting. In the theory section, the concepts of intellectual and human capital will be described, followed by a presentation of relevant theories. In the next section, we will describe the standards, regulations and additional key concepts that are applicable to this thesis.

4.1 Theory

4.1.1 Intellectual capital and human capital
This bachelor thesis is centered on the concept of human capital, which is one of the three components of intellectual capital. Therefore, we find it relevant to introduce our readers to these key concepts, as we believe that this will facilitate the future reading and understanding of our thesis. In this section we will provide the chosen definitions that we have found appropriate for the study, and we will also explain what these concepts consist of and why they are considered important for companies.

Traditionally, companies have had a main focus on financial and physical capital for creation of value, but with time the global economy has changed and knowledge has arisen as a vital part of value creation. With this, companies are increasingly reliant on their intellectual capital, which is said to consist of a company’s intangible resources (Dumay & Lu, 2010). Edvinsson who in the 90’s was the Director of Intellectual Capital at the Swedish assurance company Skandia, defines intellectual capital as “... the possession of the knowledge, applied experience, organizational technology, customer relationships and professional skills that provide Skandia with a competitive edge in the market” (Edvinsson, 1997, p. 44). This definition, albeit made for Skandia, has become widely recognized and is now thought of as a general definition of intellectual capital. Edvinsson (1997) has further tried to explain the importance of intellectual capital in a company, by using a tree as a metaphor. He explains that the visible parts of the tree are the company’s appearance to the market, while the fruit on the tree represents the products sold and profits made. For the tree to grow and be healthy it is dependent on what is hidden beneath the ground, the root system, and in a company this hidden root system consists of intellectual capital. As Edvinsson was early to describe, and as many companies have realized as the economy has changed and become more knowledge-based, intellectual capital is important for the companies’ well-being.

Intellectual capital has been classified in two main ways by previous literature. One categorization of intellectual capital consists of human capital, internal structure and external structure (Vandemaele et al, 2005). Another categorization consists of the three components relational capital, structural capital and human capital (Curado et al, 2011). The two categorizations are in theory the same, the only thing that differentiate them is the terminology. This study will be built on the latter of the two definitions where relational capital refers to the social capital that exists within and around the company. It encompasses, for example, social relations with suppliers and investors, customer loyalty, brands, distribution channels and
business alliances. Structural capital, on the other hand, refers to intellectual property such as patents and different kinds of infrastructural assets like corporate culture and information systems. The last component of intellectual capital is human capital that consists of the individual competencies of both the managers and the employees in the company. It incorporates elements like work-related skills, knowledge, education and experience. Furthermore, the term also incorporates a company’s innovativeness and creativity (Curado et al, 2011; Edvinsson & Malone, 1997). Abeysekera and Guthrie (2004, p. 253) summarize it well when they define human capital as “...a combination of factors possessed by individuals and the collective workforce of a firm. It can encompass knowledge, skills and technical ability; personal traits such as intelligence, energy, attitude, reliability, commitment; ability to learn, including aptitude, imagination and creativity; desire to share information, participate in a team and focus on the goals of the organization”, which is the definition of human capital that we have chosen to use throughout the thesis since it corresponds with our view on human capital.

<table>
<thead>
<tr>
<th>Relational capital</th>
<th>Structural capital</th>
<th>Human capital</th>
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<tbody>
<tr>
<td>Customers</td>
<td>Intellectual property</td>
<td>Employees</td>
</tr>
<tr>
<td>Suppliers</td>
<td>Corporate culture</td>
<td>Individual knowledge</td>
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<tr>
<td>Distribution channels</td>
<td>Knowledge sharing</td>
<td>Personnel retention</td>
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<td>Customer loyalty</td>
<td>Leadership</td>
<td>Expertise</td>
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<td>Distribution networks</td>
<td>Information systems</td>
<td>Competence</td>
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<td>Brand recognition</td>
<td>Collective knowledge</td>
<td>Education</td>
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<tr>
<td>Reputation</td>
<td>Brands</td>
<td>Know-how</td>
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Source: Adapted from Curado et al, 2011, p. 1084-1085

In today’s society where a company is exposed to increased competition and where a firm’s success highly depends on its flexibility and innovativeness, human capital has become an increasingly important factor. Skilled employees with the right know-how can be the competitive advantage needed to survive in today’s environment (Alvares Dominguez, 2011). Nowadays the personnel is considered as a resource to the company and not seen as a cost that needs to be reduced (Abhayawansa & Abeysekera, 2008). In contrast to this, layoffs are still made in times of economic recessions even though many claim that their employees are the company’s most important resource and studies show that human capital is disclosed less frequently than both relational and structural capital in annual reports (Dumay & Lu, 2010). As seen, the view on human capital has changed and many companies have now realized the importance of their employees, even though this is not always reflected in their annual reports. With this thesis we want to identify what types of explanations the companies have for their voluntary disclosure of human capital.

4.1.2 Isomorphism
This section will describe the theory of isomorphism, followed by a discussion of how this theory is applicable to our bachelor thesis. DiMaggio & Powell (1983) discuss the similarity of organizations in their well-known article *The Iron Cage Revisited*, where they define isomorphism as the processes that make organizations similar to other organizations, which is especially relevant for organizations with the same environmental conditions. There are three
different types of isomorphism: coercive, mimetic and normative. The coercive type of isomorphism occurs when organizations become more and more alike due to external pressure. This pressure can be political, from the state in form of laws and regulations, or connected to the problem of legitimacy. Mimetic isomorphism appears when an organization copies another organization, due to uncertainty and is most likely to occur when the goals are vague and the technology is uncertain (DiMaggio & Powell, 1983). By imitating more successful organizations, less successful organizations do not have to come up with their own solutions and therefore can save both money and time (Eriksson-Zetterquist, 2009). Since there are a limited number of consultancy firms that help other organizations to improve, similar models are likely to be applied, resulting in isomorphism. The last type of isomorphism is normative and occurs as a result of professionalization. Professionals learn similar values, ideas and norms in school and bring this knowledge to their work. Furthermore, the key personnel get internal training and get to participate in external workshops in order to learn new trends and models (DiMaggio & Powell, 1983). The fact that organizations become more alike makes them more legitimate and also facilitates recruitment and transactions (Eriksson-Zetterquist, 2009). Moreover, isomorphism contributes to the success of organizations and enhances their chances of survival (Meyer & Rowan, 1977).

As described, there are three different types of isomorphism, all giving different explanations to the similarities of organizations. For this thesis, both the mimetic and normative types of isomorphism might be applicable since we want to analyze if the companies in the auditing industry are influenced by each other. Furthermore, the coercive type will not be used since this study focus on the voluntary disclosure on human capital, which is not affected by, for example, laws and regulations.

4.1.3 Legitimacy theory
To be able to analyze whether the selected companies disclose voluntary information on human capital in order to enhance their legitimacy, we present here the legitimacy theory. Several authors use the concept of legitimacy without defining it, however Suchman (1995, p. 574) defines it as: “...a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions.” In other words, the company is considered to be legitimate if its actions and goals are congruent with the norms and values of the society (Dowling & Pfeffer, 1975). Frequently, it is less apparent when legitimacy is present than when it is absent, and the risk of comments and attacks increases as the level of legitimacy decreases (Eriksson-Zetterquist, 2009).

Status and reputation are frequently associated with legitimacy, and the literature in the different fields is similar. One important difference between the three concepts is that legitimacy’s key function is to eliminate negative problems in order to achieve an acceptable level, whereas status and reputation focus on positive accomplishments. Furthermore, legitimacy is non-rival, which means that organizations do not need to compete with one another in order to enjoy legitimacy. As a consequence, legitimacy is also homogenizing, acting as an incentive for organizations to have the same form (Deephouse & Suchman, 2008). To conclude, companies seek to obtain legitimacy, and we want to see if this search can affect the auditing firms’ voluntary disclosure of human capital.
4.1.4 Stakeholder theory

In this section the stakeholder theory will be presented, followed by a reflection on how this theory might be applicable to our thesis. The idea of the stakeholder theory was first presented in the 1980’s, and has since then become increasingly important. The theory seeks to explain the relations that companies have with external parties and the importance for companies to take the stakeholders’ interests into consideration (Wagner Mainardes, 2011). Freeman and Phillips (2002, p. 333) explain in their article Stakeholder theory: A Libertarian Defense that “...an organization’s success is dependent on how well it manages the relationships with key groups such as customers, employees, suppliers, communities, financiers, and others that can affect the realization of its purpose. The manager’s job is to keep the support of all these groups, balancing their interests, while making the organization a place where stakeholder interests can be maximized over time.” In order to understand this theory it is important to comprehend the concept of stakeholders. Stakeholders can be said to be any individual or group that have a claim or interest in a firm’s activities. They can be divided into two main groups: primary and secondary stakeholders. Individuals or groups that the company would not be able to survive without are considered to be primary stakeholders, and examples of these are employees, suppliers and customers. Secondary stakeholders, on the other hand, are not necessary for the company’s survival but they can still affect and influence, or be affected and influenced, by the firm. A good example of a secondary stakeholder is the media (Clarkson, 1995). The figure below aims to illustrate the interdependence that exists between the firm and its stakeholders.

As described, there are several stakeholders who can affect, or be affected, by a firm and its actions, and the stakeholder theory deals with these relations. In this study, we want to see if the interviewed companies have any particular stakeholders in mind when they disclose information concerning human capital in their annual reports.
4.1.5 Communication strategy: Reactive or Proactive
Companies can use either a proactive or reactive communication strategy when selecting what information to disclose in their annual reports. A reactive communication strategy is when a company does not disclose certain information until the demand from stakeholders is strong enough. In other words, the company does not actively consider which information to disclose but solely reacts to external demand. When a company, on the other hand, tries to foresee the needs of their stakeholders and communicates this information before a request has been made, they are said to use a proactive communication strategy (Catasús & Nobrand, 2011). According to Catasús and Nobrand (2011), companies with a proactive strategy benefit from receiving increased attention from analysts. They also benefit from greater consensus about company results in the capital market, due to reduced information asymmetry. Despite the mentioned benefits, studies show that there are few firms that apply the proactive communication strategy for their disclosure on intellectual capital but that the likelihood of using the strategy increases with both company size and market-to-book ratios (Guthrie & Petty, 2000; García-Meca et al, 2005). It would be interesting to see if the interviewed companies apply either a reactive or a proactive communication strategy.

4.2 Standards and human capital reporting

4.2.1 Financial accounting standards
The main purpose of financial accounting is to supply users with information that they can use as a basis for decision-making, therefore it is important that the financial reports are produced according to certain standards so that the company’s financial performance is described in a fair manner. According to the International Accounting Standard Board (IASB), information is said to be useful for decision-making when it is relevant and gives a faithful representation of a company’s performance. This applies when the information is comparable, verifiable, timely and understandable (IASB, 2001). For users to be able to form a picture of a company’s situation it is important that they can compare financial reports both over time and between different companies. It is also important that the information is relevant to the users, which it is said to be when the information is present, essential and comprehensible. Lastly, the information needs to be reliable to be useful for decision-making. Information is said to be reliable when it reflects the reality in the best possible way and is enhanced when the information can be verified. In other words, information is reliable when it is not biased (IASB, 2001; Smith, 2006). This is not solely a requirement in international law; the Swedish Annual Accounts Act (ÅRL 2:3) also obliges companies to display a true and fair image of the company in their annual reports. To achieve this, the companies need to disclose enough information so that the users can interpret the results correctly (Catasús & Nobrand, 2011). As described above, the information in the annual report needs to be relevant and give a faithful representation of the company, so that the users of the annual report can gain a true understanding of the company and its business. We want to identify if the persons that we have interviewed uses any of these accounting standards as explanations for their voluntary disclosure of human capital.

4.2.2 Mandatory and voluntary information
In this study we focus on voluntary disclosure of human capital in annual reports, in other words, the information that companies provide besides the mandatory information required by Swedish law. In order to better understand this thesis, we believe that a basic knowledge of the Swedish
law is necessary; consequently we here provide a brief overview of the requirements followed by a section concerning voluntary information.

According to the Swedish Annual Accounts Act (ÅRL), companies have to disclose certain information concerning their employees. The following information is compulsory to disclose in the annual report: the mean number of employees, the payroll expense, and the gender balance in the corporate management. Chapter 5, §18 states that information concerning the mean number of employees during the financial year, as well as the distribution of men and women, should be disclosed in the annual report. This information is usually disclosed as a note to the income statement and presented in a table. If the company has employees in several countries, the mean number of employees and the distribution of men and women should be disclosed for each country. Salaries, remunerations and social security expenses are regulated in chapter 5, §19-20, which states that smaller companies that are public limited liability companies and larger companies must give information concerning the total salaries and other remunerations of the financial year for each of the following groups:

1. Board members, CEO and corresponding officers of the company, and
2. Other employees than the ones mentioned above.

This information is most frequently disclosed as a note to the item payroll expenses, and presented as a table. Information concerning the gender balance in the corporate management is regulated in chapter 5, §18b. If a company has more than ten employees, there is a requirement to disclose the distribution between men and women among board members, as well as CEO’s and corresponding officers of the company. The information should reflect the distribution on the reporting day. The administration report is regulated in chapter 6, §1, which states the different requirements that must be included in the administration report. It also states that information concerning the environment and the employees should be included, if needed in order to comprehend the company’s development, financial position or performance.

Above, we have provided a brief overview of the mandatory information concerning human capital, implying that the rest of the information on human capital disclosed in the annual report is voluntary. Voluntary information gives the companies a possibility to make the mandatory financial information easier to comprehend for the users and this information is often presented in the beginning of the annual report (Catasús & Nobrand, 2011). Moreover, through the voluntary information, companies can choose to disclose information they consider important in order to give a clear picture of the business, and it is this information that this study will focus on.

4.2.3 Central concepts
The purpose of this thesis is to identify and discuss the explanations behind why auditing firms choose to disclose voluntary information in their annual reports. Subsequently, our definitions of the concepts explanations, disclosure, advantage and disadvantage will be presented in order to facilitate the understanding of this thesis. In this study, the concept explanations will signify the reasons provided by the interviewees from the three auditing firms regarding why they choose to disclose voluntary information on human capital. These explanations can, for instance, be expressed as: “For us it is important to show our employees in the annual report, since ...” or “If we did not disclose this information, it could signify ...”. Further, disclosure will imply the information concerning human capital that the companies choose to include in their annual reports. Lastly, the concepts of advantage and disadvantage will in our study be compared to the
more economic terms cost and benefit, where advantage will signify a benefit and disadvantages will signify a cost for the firm. With this brief section, where our definitions of the key words of this study have been provided, we have strived to ease the comprehension of this bachelor thesis.

4.2.4 Users of the annual report
As mentioned earlier, the purpose of financial accounting is to inform the users of the annual report about the company and its financial situation. The annual report is considered an important document for dispersing this information, and the producers of the report consistently need to consider which information they want to share to the public. Among the potential users of the information in annual reports we find existing and potential creditors, suppliers, investors, employees, customers and government agencies. Since all these have different needs for information it is also necessary for the producers to contemplate over which users they consider most important. The selected auditing firms in this study are all partner-owned; therefore they can disregard the need of investors and instead focus on potential and existing customers and employees. Customers can use the information in the annual report to see if the company has the ability to continue its’ activities and if they can meet their obligations. Employees, on the other hand, can use the information to determine if the company is stable enough to pay out salaries and pensions (IASB, 2001; Smith, 2006).

4.2.5 Two types of information
The information included in the annual report can be presented either in qualitative text or in numbers. Hence, the annual report includes both soft and hard information. Hard information is processed by using analytical methods, and is quantifiable. It is frequently presented in diagrams since the information is offered in numbers, codes or symbols. Hard information can, for example, be used as a basis for decision-making, in order to reduce uncertainty. Examples of soft information are ideas, visions and values, which are influenced by norms and traditions. This kind of information is qualitative and has a connection to creativity and fantasy, and is frequently subjective and descriptive. Moreover, soft information can more easily be manipulated, in terms of substance, than hard information (Häckner, 1985). In this bachelor thesis, we mostly focus on the soft information since this is where voluntary disclosure concerning human capital is most frequently found.
Chapter Five: Empirical Findings

In this fifth chapter, we will present the results from our interviews concerning why the companies choose to disclose information concerning human capital in their annual reports. Worth mentioning is that all companies disclose human capital information on their websites and in other official documents besides their annual reports. However, the purpose of this study is to focus on the disclosures made in the companies’ annual reports.

5.1 The Smaller Company A

The Smaller Company A belongs to an international organization and is the smallest auditing firm in our study, given the number of employees. The person that we have interviewed is CA, Chief of Administration, and has worked at the company since 2010. Prior to that, the interviewee has worked as a senior manager and consultant at different companies. The CA manages the staff and support functions and handles the soft information that is presented in the administration report, where human capital is included. In their annual report, the Smaller Company A discloses some voluntary information on human capital besides the mandatory requirements. This information is qualitative and is first and foremost presented in the administration report. However, this information is quite brief.

5.1.1 Thoughts on human capital

For the interviewee, the word human capital signifies the value that the employees create for the company, and consists of experiences, industry knowledge, competencies and networks. In other words, all that the employees bring to the company when they are recruited and everything that they learn during their employment, which they can use when providing services to clients. The CA emphasizes the importance of relations and networks that the employees possess, since this facilitates the company’s ability to sell, deliver and market itself. The quotes mentioned below are all derived from the interview with the CA of the Smaller Company A.

“Experiences, skills and networks – the value that the employees create for the company.”

The Smaller Company A does not have a pronounced strategy for how to disclose information on human capital, but when changes occur they are due to an internal initiative. The interviewee cannot recall any specific external demands for additional information concerning human capital. However, the company belongs to an international organization that has specific demands on its quality and brand, and it is not impossible that they might have an opinion about what the Smaller Company A publishes about themselves.

It is the board of directors that have the ultimate responsibility for the contents in the Smaller Company A’s annual report. Consequently, the board decides what information that should be included, but several other persons are involved in the process of producing the report. As mentioned earlier, the CA handles the soft information that is presented in the administration report, where human capital is included, while the CFO handles the hard information, where the income statement and balance sheet are included. All of the persons involved in the process of
producing the report can make suggestions on how to develop and improve the report, but the board still has the final call.

5.1.2 Why the Smaller Company A chooses to disclose voluntary information on human capital in their annual report

“The contents of the annual report depends to a great extent on tradition, at one point it has been decided what to include and this has not changed considerably since then.”

What is included in the annual report is mostly due to tradition and the interviewee says that at one point in time it has been decided what to include in the annual report and that this has not changed considerably since then. The interviewee explains that one of the main reasons why the Smaller Company A chooses to disclose information on human capital is to make the company come alive in the eyes of the users, to show more than just hard facts and numbers.

“Through human capital disclosure you can bring the company alive and show that it consists of more than just hard facts and numbers.”

The Smaller Company A also wants to show that they are an organization based on resources and competencies, with skilled employees that deliver services of quality. The CA claims that it is a question of credibility, and means that the credibility decreases if the company does not disclose any information on human capital. In conclusion, they disclose information on human capital to show what the company is like behind the numbers, as a way of marketing themselves and to prove that they have the resources that they claim to have. Since the company is partner owned, there are no external owners or investors that need to be informed. Instead, the Smaller Company A addresses their information to existing and potential customers, and as a recruitment tool for both students and more experienced workers.

“Next years annual report will include more information on human capital.”

Furthermore, the CA of the Smaller Company A claims that they have realized that their present annual report should be expanded. At the moment it is quite limited, with only a little information on human capital included in a brief administration report. Starting from next year, the Smaller Company A will restyle its annual report and include even more information about its human capital. One of the reasons for this change is that they want to provide a more attractive annual report that can be distributed to interested parties, and the interviewee believes that this idea was raised as a consequence of both competitor analysis and internal demand. The plan for next year’s annual report is to describe the employees and their competencies in text and pictures. A possible change could be to describe a real employee, for example Eva who has worked as an auditor for seven years. The idea is to portray Eva’s development within the firm, for example the different internal courses that she has completed. The CA gives an example of what this could look like:

“Eva has worked as an auditor here for seven years, and she has attended these internal courses and is now capable of supplying these services.”
The interviewee means that these changes will make the annual report more personal, which hopefully will make the report more attractive to users. During the last two years, the Smaller Company A has been working on their brand and how they present themselves, and consequently the intended changes of the annual report are yet another step in this process.

### 5.1.3 Perceived advantages and disadvantages with human capital disclosure

When asked about the advantages of disclosing voluntary information on human capital, the interviewee points out the possibility to show more than just pure numbers. The voluntary information is a way for the company to describe their strengths and resources. By showing for example the number of certified auditors the company can illustrate the employees’ competencies and knowledge. Disclosing this information can be a way for the company to show that they care about their employees and their level of competence. It is also a way to give a clearer picture of the company and can work as a marketing tool. The interviewee emphasizes that these are general advantages, and that it can be discussed if the Smaller Company A succeeds with this in their current annual report.

> “It is a way to show what our strengths and resources are. We can, for example, illustrate our employees competencies and knowledge by disclosing the number of certified auditors.”

According to the CA, there are two main disadvantages with voluntary disclosure of human capital. Firstly, excessive disclosure might jeopardize the integrity of the employees. As an example, it is important to consider what information to disclose concerning sick leave, since excessive information might highlight specific staff problems. Secondly, the information might lead to a competitive disadvantage and by disclosing too detailed information about salaries or special competencies within the staff; the company might be exposing themselves to external headhunters. Furthermore, the interviewee mentions certain information that might be sensitive to disclose, for example employee turnover, wage level and remunerations to partners. One must also make sure that the statistics and the hard facts are in line with the more soft information; that the company actually can deliver the services that they claim to be able to provide.

### 5.2 The Larger Company A

The Larger Company A belongs to a global organization and is one of the larger auditing firms in our study, given the number of employees. The person that we have interviewed has a combined post, working both as COO, Chief Operating Officer, and CFO, Chief Financial Officer, and has worked at the company for 17 years, as a consultant and in the management. The interviewee has worked as COO/CFO for the last five years and the post involves, for instance, the responsibility for finance, internal processes, strategic questions and partner issues. The interviewee has the ultimate responsibility for the company’s annual report, as well as their sustainability report. In their annual report, the Larger Company A discloses considerably more voluntary information on human capital than what is mandatory and the information is described quite thoroughly in text, key ratios and in notes. Furthermore, the report includes pictures of the company’s employees in different situations and environments.

### 5.2.1 Thoughts on human capital

The interviewee emphasizes that for them the human capital is almost the entire value of the firm. The COO/CFO estimates that 98 % of the firm’s value consists of human capital, since they do not produce any products and only have relatively few fixtures, such as computers. Human
capital is also the foundation of the company’s strategy, since they believe that if they recruit and retain the best employees, they will deliver services of high quality that the customers will be willing to pay for. This leads to a positive spiral that will facilitate recruitment and retention of the best employees.

“We believe that if we recruit and retain the best employees we will be able to deliver services of high quality that the customers will buy. This will lead to a positive spiral, which will enable future recruitment and retention of the best employees.”

The Larger Company A does not have a pronounced strategy for how to disclose information on human capital, but they continuously have a dialogue concerning what they consider relevant to disclose in the annual report. The company wants to be as transparent as possible without compromising their competitive position, and the interviewee stresses that they regularly have dialogues with their stakeholders on how the company can improve. As a consequence of the dialogue with the employees, the Larger Company A has chosen to disclose more information concerning sick leaves, to show how this is developing. Moreover, the interviewee clarifies that there are legal requirements regarding the contents of the annual report, but other than that, the disclosure depends mostly on what the company’s management consider relevant to show.

Officially, it is the board of directors that approves the final annual report, but in reality it is the COO/CFO together with the Human Resource-manager that decide what information that is relevant to disclose concerning human capital. They also make sure not to include information that might benefit their competitors. Their proposal is then referred to the management and board of directors for consideration before the final approval of the annual report. Furthermore, the interviewee accentuates the fact that the annual report contains less information concerning human capital than the sustainability report, and for this year’s documents the distribution of human capital information will be even clearer.

5.2.2 Why the Larger Company A chooses to disclose voluntary information on human capital in their annual report

“Human capital is this company’s most important value driver, and we therefore believe that it is this information that interest our stakeholders the most.”

The Larger Company A chooses to disclose information on human capital since it is the company’s most important value driver, and therefore they believe that it is this information that the stakeholders are most interested in. As mentioned before, the human capital is such an important part of the company’s strategy and thus it is essential that both the employees and the customers understand this strategy when reading the contents of the annual report. The interviewee also emphasizes the importance of a similar view among the partners, that all of them understand the importance of the employees and the need to take good care of them, which requires continuous investment in their development. By describing their human capital thoroughly in the annual report, the Larger Company A hopes to unite the partners under this common view. The interviewee continues on with saying that the company’s most important asset does not show on the balance sheet, and therefore it is even more important to show the readers of the annual report where the true value of the company lays.
“Our most important asset is not shown on the balance sheet, and therefore it is even more important to show the readers of the annual report where the true value of our company lays.”

The Larger Company A addresses their information on human capital to all of their stakeholders, but primarily to partners, employees, customers, students, suppliers and regulators. Due to the fact that the company is partner-owned, analysts and investors show little interest in their annual report. Hence, the company can focus on their primary stakeholders. The company not only chooses to disclose information on human capital in text and in notes, but also by disclosing pictures of their employees in different environments. The interviewee explains that they use pictures to lighten up the annual report and also to illustrate what a possible day can look like for the employees.

5.2.3 Perceived advantages and disadvantages with human capital disclosure

During the interview the COO/CFO continuously highlights the importance of the employees and stresses that through human capital disclosure the company can give an increased understanding for the importance of human resource-related questions. Other advantages with human capital disclosure are that the company can make the employees aware of their importance to the firm, and through the disclosure they can ensure that the partners understand the essentialness of investing in the employees. An additional advantage is that the customers can gain an understanding for the employees’ development and therefore increase their confidence in the people providing services. The interviewee also stresses that an auditing firm should contribute to enhance the credibility of the financial information, and the Larger Company A therefore feels the need to set a good example by being as transparent as possible with their information.

“We have received a lot of positive comments about the fact that we are very transparent, both from employees and customers.”

According to the interviewee, there are two main disadvantages with voluntary disclosure of human capital. One disadvantage is that information concerning the employees can be a sensitive matter, and they feel that they do not want to disclose information that might cause disharmony within the workforce. They want the disclosed information to convey a positive spirit and avoid information that can create a sense of “us” and “them”. The interviewee mentions that the company has a rating-system where they rate their employees from different perspectives. This information is sensitive to disclose since it can compromise the integrity of the personnel. If the company were to disclose the average rate from this evaluation, half of the workforce would feel insufficient and less successful, which the management wants to avoid. Furthermore, the information can lead to a competitive disadvantage for the firm if they disclose information that their competitors can benefit from. The interviewee claims that the company would like to disclose even more information concerning their human capital, for example what strategic initiatives they undertake and what measures they use in order to attract and retain employees. However, they have chosen not to disclose this information since it might benefit their competitors and make the Larger Company A’s investments wasted. The interviewee also emphasizes that they have made an active decision not to disclose information concerning their wage and bonus-models and what activities they undertake towards universities in order to attract
students, since this kind of information can be very important for competitors. The interviewee concludes:

“Unfortunately, in some situations we need to be quite secretive.”

5.3 The Larger Company B
The Larger Company B belongs to a global network and is one of the two larger auditing firms in our study, given the number of employees. The person that we have interviewed works as CFO, Chief Financial Officer, and has worked at this position since 2009. Prior to that, the interviewee has worked as, for example, chartered accountant and management consultant, and has all in all worked in service-companies for over 25 years. The CFO is, together with the rest of the management, involved in the process of producing the annual report.

In their annual report, the Larger Company B discloses some voluntary information concerning human capital besides what is mandatory by Swedish law. This information is mostly qualitative and is first and foremost presented in the administration report. However, this information is quite brief. In addition to this, the company also discloses a few key ratios related to the employees. Worth mentioning is that the Larger Company B provides what they call a popular version of their annual report besides the more formal one, where they disclose more information on human capital. For example, they only disclose information concerning sick leave in the popular version. However, since this popular version only includes an abbreviated version of the balance sheet and income statement, without any notes, we have decided to focus on the formal one.

5.3.1 Thoughts on human capital
For the Larger Company B, human capital is both the employees that perform services to customers, as well as the company’s main source of income. The CFO accentuates that human capital is a valuable resource, since it is a crucial factor for the company’s long-term success and adds that it is important not to confuse the two concepts of human capital and structural capital.

“For a company like ours, human capital is the most decisive factor for the company’s long-term success. Consequently, we work extensively with questions concerning culture and brand. We also invest a lot in employer branding and aim to be the best employer in both our and related industries.”

The Larger Company B does not have a pronounced strategy regarding their disclosure of human capital information. However, they strive to provide the information that customers as well as employees request, this in order to facilitate their decision to choose the company as their supplier or employer. Further, the interviewee believes that it is more important to focus on their market oriented actions and brand, than on guidelines concerning human capital disclosure. The interviewee adds that they are content with what they are showing at the moment, but when talking about the future of human capital disclosure the CFO states:

“I believe that in the near future, companies will have to disclose human capital information in a certain way. It will be part of a checklist that companies will have to fulfill in order to be perceived as okay.”
5.3.2 Why the Larger Company B chooses to disclose voluntary information on human capital in their annual report

“Since we are one of the larger companies in professional services, I believe that we are expected to disclose the information concerning human capital that we do.”

The CFO states that they first and foremost disclose information concerning human capital in order to show that it is the company’s most important factor of success. Further, the interviewee claims that it goes without saying that service-companies should disclose information regarding human capital, since it is the employees that are the companies’ most strategic asset. Moreover, the company would not survive and develop if it were not for the personnel. The CFO states:

“For us, it is just as obvious to disclose our employees in our annual report as it is for Volvo to disclose their cars. We have to highlight our human capital since it is by far our most important factor of success.”

The interviewee also says that through their human capital disclosure they want to show that they are a modern and progressive company, with the individual in focus. Additionally, it is important that the customers feel that the company aim to attract employees that the customers would like to work with. Just as the company in their sustainability report wants to show that they care about the environment, they also want to highlight the fact that they are a modern company that cares about their employees in their annual report. Further, the CFO claims that the disclosure is a question of credibility and says:

“We would have a major credibility issue if we did not disclose any information concerning human capital at all. It would be extremely doubtful if we would tell all of our employees that we believe and invest in them, and that we want to offer them the best career opportunities, but in the end chose not to show this in the annual report.”

The Larger Company B addresses their information in the annual report to all external stakeholders, but focuses mainly on the customers, employees and potential recruitments. They want to convey to the customers that they are a company that cares about their employees, have a sound culture and solid values. They also want to convey to their existing employees that they care about them, as well as inform students and other potential recruitments how they treat their human capital.

5.3.3 Perceived advantages and disadvantages with human capital disclosure

When asked about the perceived advantages with human capital disclosure, the interviewee emphasizes the opportunity to market their company, to show the company’s factor of success, and to show that they are a modern and progressive company with the individual in focus. Furthermore, the CFO accentuates that the company is proud of their personnel and wants to convey this message to the stakeholders, and adds that human capital disclosure can serve to attract and retain employees.

“The main advantage is that we through human capital disclosure can promote our brand.”
According to the interviewee, a potential risk with human capital disclosure is that it, if you are being too transparent, can negatively affect your company both financially and strategically, which can harm your competitive position. As an example, it is sensitive to disclose information regarding the employees’ wage levels because of two different reasons. Firstly, if the company was to disclose a newly graduated student’s salary, and this was considered to be too low, it could affect the brand negatively since no students would want to work there. If, on the other hand, the salary was considered to be too high, this could affect their business since the customers might feel that the company’s services were over-charged.

"Information concerning wages and remunerations is considered sensitive to disclose in the annual report. For example, we would not want to disclose what a newly chartered accountant earn, since this could harm our business."

Additional information that the Larger Company B would not like to disclose would be if they had problems concerning employee turnover or sick leave and the CFO concludes that there are certain business secrets that they cannot possibly disclose. Moreover, the interviewee claims that it can be a challenge to measure human capital in terms of key ratios. A lot of these ratios can be measured in many different ways, which can lead to quality problems when analyzing and benchmarking measures. Therefore, the CFO believes that information concerning human capital is, in most cases, better presented in text than in tables.
Chapter Six: Analysis

In this sixth chapter, we will analyze the empirical findings presented in chapter five and connect these to the previous research and the frame of reference presented in chapter two and four. In this section we will also compare if the companies give similar or different explanations for their voluntary disclosure of human capital.

6.1 Why the companies choose to disclose voluntary information on human capital in their annual reports

In this section we intend to discuss and compare the interviewed companies’ explanations for why they choose to disclose voluntary information concerning human capital in their annual reports. In order to achieve this we will also discuss the perceived advantages and disadvantages with voluntary disclosure since these perceptions might influence the companies’ disclosure rationale.

All of the interviewed companies emphasize that their employees are extremely important for the business and the company’s survival, and all of them claim that a main reason for their disclosure of human capital information is to highlight the importance of the employees. The Smaller Company A explains that one reason for their disclosure is to show what the company is like behind the numbers and to show that the company is based on skills and competencies. The Larger Company A explains that they disclose this information to show where the true value of the company lays, since they emphasize that the employees are the company’s most important value driver. Furthermore, the CFO of the Larger Company B explains that they disclose human capital information since it is crucial for the company’s long-term success, and adds that the company would not survive and develop if it were not for their employees.

“For us, it is just as obvious to disclose our employees in our annual report as it is for Volvo to disclose their cars. We have to highlight our human capital since it is by far our most important factor of success.”

- The CFO of the Larger Company B

The above explanations provided by the interviewed companies are in line with two of the incentives that Beattie & Smith (2010) present regarding voluntary disclosure of human capital. The first incentive is to inform external stakeholders of the employees’ competencies, which is evident in the explanation provided by the Smaller Company A when they say that they want to show that they are an organization based on skills and competencies. In the case of the Larger Company A, the connection might not be as clear, but as the company discloses information regarding their most important value driver, they automatically disclose information about the employees and their competencies and skills. The same logic goes for the Larger Company B’s explanation. The second incentive offered by Beattie & Smith (2010) is that the voluntary disclosure can enhance the likelihood of future prospects. By disclosing their employees’ knowledge and skills, the companies show their existing and potential customers that they have the ability to provide quality services, which enhances their probability for future prospects. The Larger Company A describes this with the following quote:
“We believe that if we recruit and retain the best employees we will be able to deliver services of high quality that the customers will buy. This will lead to a positive spiral, which will enable future recruitment and retention of the best employees.”

- The COO/CFO of the Larger Company A

The Smaller Company A states that they disclose voluntary information on human capital in their annual report in order to make the company come alive in the eyes of the users. This is similar to findings made by Rimmel (2003), that human capital disclosure is considered to be important since it is a way to illustrate and improve the overall impression of the firm. The Larger Company A has found an additional way to illustrate and improve the overall impression of the company, namely by disclosing pictures of their employees in everyday situations.

“Through human capital disclosure you can bring the company alive and show that it consists of more than just hard facts and numbers.”

- The CA of the Smaller Company A

Furthermore, all of the companies emphasize the importance of disclosing information that increases the trustworthiness of the company, which according to Beattie and Smith (2010) is another incentive for voluntary disclosure of human capital. The Larger Company A talks about this in terms of transparency to their stakeholders, and claims that they want to be as transparent as possible in order to enhance the credibility of the financial information. Additionally, the Smaller Company A and the Larger Company B both talk about trustworthiness in terms of credibility. The CA of the Smaller Company A claims that since they are a knowledge-based company, their credibility increase with their disclosure of human capital information, while the CFO of the Larger Company B states that:

“We would have a major credibility issue if we did not disclose any information concerning human capital at all. It would be extremely doubtful if we would tell all of our employees that we believe and invest in them, and that we want to offer them the best career opportunities, but in the end chose not to show this in the annual report.”

- The CFO of the Larger Company B

One explanation mentioned by both the Smaller Company A and the Larger Company B, is that they use the disclosure of human capital information as a way of marketing themselves. This is in consonance with the findings of Beattie & Smith (2010), namely that voluntary disclosure concerning human capital can serve as an important marketing tool. The authors also found that the external disclosure of human capital is an important recruitment tool, which the Smaller Company A and the Larger Company B also give as an explanation for their disclosure. This can also be indicated by the Larger Company A, since they claim that they address their human capital disclosure to for example students.

6.1.1 Advantages with voluntary disclosure of human capital

The Larger Company A claims that a main advantage with voluntary disclosure of human capital is the possibility to increase the stakeholders’ understanding for human resource-related questions, which is important for the company since their employees are such a significant part of
their strategy. The primary stakeholders of this information are the company’s employees, customers and partners. In previous research, it has been observed that one incentive with voluntary human capital disclosure is to motivate the employees (Beattie & Smith, 2010), which the Larger Company A can be said to do when they through their annual report make the personnel aware of their importance to the firm. Another incentive with voluntary disclosure is to inform external stakeholders of the manager’s competence (Beattie & Smith, 2010), which the Larger Company A does when they explain that they disclose human capital information so that the customers can gain an understanding of the employees’ development. The company also emphasizes that an advantage with this disclosure is that they, through the information, can make the partners understand the importance of investing in the employees. The Larger Company B explains that through human capital disclosure they can inform their customers of the fact that the company aims to attract employees that the customers would like to work with, which the company believes is a very important message to convey. Moreover, since all of the interviewed companies are partner-owned they do not disclose voluntary information in order to increase the transparency to capital markets, which Alvarez Dominguez (2011) states is an advantage with this disclosure.

“It is a way to show what our strengths and resources are. We can, for example, illustrate our employees competencies and knowledge by disclosing the number of certified auditors.”
- The CA of the Smaller Company A

During the interview the Smaller Company A also provides some general advantages with voluntary disclosure of human capital, and the CA stresses that it can be discussed if the company succeeds with this in their current annual report. However, one of these general advantages is to describe the company’s strengths and resources, which the above quote indicates. The quote can also be seen as a way for the Smaller Company A to enhance the likelihood of future prospects, which is an incentive mentioned earlier in this analysis. Further, Alvarez Dominguez (2011) found in a previous research that human capital disclosure enhances corporate image, and this is something that the Larger Company B can be said to strive for when they describe their company as modern and progressive in their annual report. Finally, all of the companies claim that it is an advantage to be able to show their employees that they care about them, which can be seen as a way of motivating the employees.

6.1.2 Disadvantages with voluntary disclosure of human capital

While the perceived advantages with human capital disclosure vary between the companies, all of them agree on the main disadvantage with this disclosure, namely that it might imply a competitive disadvantage for the firm. Curado et al. (2011), among others, argue that competitive disadvantage is a main drawback of human capital disclosure, which the COO/CFO of the Larger Company A also emphasizes. The COO/CFO accentuates that the company would like to disclose even more human capital information in their annual report, but they have decided not to do this since it might compromise their competitive position and ruin their human capital investments. Further, the CFO of the Larger Company B agrees that by disclosing too much information concerning human capital they run the risk of losing their competitive position, while the Smaller Company A mentions that by disclosing too detailed information about their staff, they might open themselves up to external headhunters.
“Unfortunately, in some situations we need to be quite secretive.”
- The COO/CFO of the Larger Company A

A second disadvantage with human capital disclosure mentioned by both the Smaller Company A and the Larger Company A is that it might jeopardize the integrity of the personnel. This disadvantage is not found in the previous research, but both companies argue that they would not want to disclose information that could harm the employees. The Larger Company A does not want to disclose information that might cause disharmony within the workforce, while the Smaller Company A states that excessive human capital disclosure might highlight specific staff problems. Additionally, there is some information concerning human capital that the companies find more sensitive to disclose, and frequently choose not to include in their annual reports. The Smaller Company A exemplifies that information regarding employee turnover, sick leaves, wage level and remunerations to partners is sensitive to disclose. The CFO of the Larger Company B agrees with the fact that information concerning wage levels is sensitive, and adds that they would not like to disclose information that could highlight problems concerning, for example, their employee turnover or sick leaves. The CFO also mentions that there are some business secrets that they cannot possibly disclose in their annual report.

“Information concerning wages and remunerations is considered sensitive to disclose in the annual report. For example, we would not want to disclose what a newly chartered accountant earn, since this could harm our business.”
- The CFO of the Larger Company B

The Larger Company A states that they do not disclose which activities they undertake towards universities in order to attract the students. Moreover, the Larger Company A also chooses not to disclose information regarding wages and bonus models. An interesting aspect is the fact that the Smaller Company A considers sick leave to be a sensitive matter to disclose in the annual report, while the Larger Company A, on the other hand, has chosen to disclose this information in their annual report. Moreover, the fact that the Larger Company B claims that they would not like to disclose information concerning for example sick leaves if they had a problem with this is even more interesting, since they actually do disclose information concerning sick leaves in their popular version of their annual report. Williams (2001) states that companies only choose to disclose information that makes them look good, while they choose to not disclose information that might be perceived as negative in the eyes of the stakeholders. Worth mentioning is also that previous research states that the cost of providing the information is a disadvantage with voluntary human capital disclosure (Beattie & Smith, 2010), but none of the interviewed companies mention this factor.

6.2 The companies’ explanations connected to the frame of reference

“The contents of the annual report depends to a great extent on tradition.”
- The CA of the Smaller Company A

The CA of the Smaller Company A says that their disclosure of human capital information in their annual report of 2010/2011 is mostly a result of tradition, but that the company from next year on will change their annual report. Starting from next year they will produce a modified
annual report that will include even more information concerning human capital, in form of both text and pictures, as a way to make the company come alive in the eyes of the stakeholders. The Larger Company A, on the other hand, intends to include the greater part of their human capital information in their sustainability report and to disclose relatively less in their annual report. In this aspect, the companies seem to have two different ideas for how they plan to disclose human capital information in the future. As an explanation for the intended changes, the CA of the Smaller Company A claims that it is a decision based on both competitor analysis and internal demand. Since the intended changes for the Smaller Company A’s annual report are partly due to competitor analysis, a connection to the theory of isomorphism can be found. As a reminder, isomorphism is the processes that make organizations similar to one another and especially applies to organizations within the same environmental conditions, in which the selected companies in this study most certainly are. According to the theory there are three different types of isomorphism, namely coercive, mimetic and normative (DiMaggio & Powell, 1983). When the CA of the Smaller Company A mentions that they intend to change their human capital disclosure as a result of a competitor analysis, a connection to the mimetic type of isomorphism is apparent, as this type appears when an organization copies another organization.

All interviewed companies explain that one perceived advantage with human capital disclosure is that the company, through this disclosure, can inform different stakeholders about the firm and the employees. The CA of the Smaller Company A, for example, explains that they disclose human capital information both to show the customers that the company has skilled employees that can deliver quality services, and to show the employees that they care about them. The COO/CFO of the Larger Company A also states that they disclose information on human capital to make the employees aware of their importance to the firm and adds that the disclosure also aim to increase the customers understanding of the employees’ development, which in turn might help the partners understand the significance of investing in their personnel. The CFO of the Larger Company B agrees that a company with their disclosure can inform their stakeholders about certain aspects, and explains that they, first and foremost, address their disclosure to existing and potential customers and employees. The statements can be said to correspond with the stakeholder theory, which seeks to explain how important it is for organizations to manage their relationships with stakeholders (Freeman & Phillips, 2002). The theory also seeks to explain the interdependence that exists between a firm and its stakeholders (Donaldson & Preston, 1995). As seen by the above statements, stakeholders can be influenced by a firm’s disclosure, but they can also influence a firm. This is clear when the Larger Company A claims that they regularly have dialogues with stakeholders on how they can improve, and the Larger Company B states that they strive to provide the information that employees and customers request. The companies also consider their stakeholders when they take an active decision not to disclose certain information. As an example, both the Larger Company A and the Smaller Company A do not want to disclose information that might cause disharmony among the personnel or hurt the integrity of the employees.

“We address our human capital information to all of our stakeholders, but primarily to partners, employees, customers, students, suppliers and regulators.”
- The COO/CFO of the Larger Company A

Furthermore, none of the companies claim to have a pronounced strategy for how to disclose
information on human capital. However, the Smaller Company A states that when changes occur they are due to an internal initiative, which then can be seen as a type of proactive communication strategy. The proactive strategy means that a company provides information before the stakeholders demand it. A reactive strategy, on the other hand, is when a company does not disclose certain information until the demand from stakeholders is strong enough (Catasús & Nobrand, 2011). The Larger Company A’s COO/CFO accentuates that they continuously have dialogues with their stakeholders concerning how the company can improve, and mentions that the company have chosen to disclose more information concerning, for example, sick leaves due to these dialogues. This can be seen as a reactive communication strategy, since the company made changes due to external demand. However, the COO/CFO of the Larger Company A also claims that their human capital disclosure mostly depends on what the company’s management consider relevant to show, which, on the other hand, can be seen as a more proactive communication strategy. Lastly, the CFO of the Larger Company B claims that they strive to provide the information that customers as well as employees request, which can be seen as a more reactive communication strategy.

“Human capital is this company’s most important value driver, and we therefore believe that it is this information that interest our stakeholders the most.”
- The COO/CFO of the Larger Company A

According to the Swedish Annual Accounts Act, information concerning the employees should be included in the administration report if it is needed in order to comprehend the company’s financial position or performance. This is something that all the interviewed companies indicate, and as the above statement made by the Larger Company A can exemplify. Further, it is also indicated by the CFO of the Larger Company B who explains that their employees are crucial for their long-term success, and that for them it is just as obvious to disclose information about their employees as it is for Volvo to disclose their cars. These explanations can also be seen to imply that the companies consider it to be relevant to disclose human capital information, in order to give a faithful representation of the company’s performance, although this is not explicitly mentioned by the interviewed companies.

Finally, the interviewees’ responses may also be connected to the legitimacy theory, which states that a company is considered to be legitimate if its actions and goals are congruent with the norms and values of the society (Dowling & Pfeffer, 1975). When the Smaller Company A mentions that their disclosure of human capital is a question of credibility and that the credibility decreases if the company does not disclose voluntary information concerning human capital, this can be seen as a step of securing legitimacy. Further, the quote below by the CFO of the Larger Company B indicates that the CFO believes that human capital information soon will have to be disclosed in a certain way in order for companies to be perceived as legitimate.

“I believe that in the near future, companies will have to disclose human capital information in a certain way. It will be part of a checklist that companies will have to fulfill in order to be perceived as okay.”
- The CFO of the Larger Company B
Chapter Seven: Conclusions

In this seventh chapter, we will provide a résumé of our findings and draw conclusions from these results, in order to fulfill our purpose.

7.1 Empirical conclusions

7.1.1 What types of explanations do auditing firms use for the disclosure of voluntary information concerning human capital in their annual reports?

When conducting this study, we have found that the interviewed auditing firms provide three main explanations for their disclosure of voluntary information concerning human capital in their annual reports. Firstly, all of the companies claim that one explanation for their human capital disclosure is that it enables them to show that their employees are such an important resource for the business and for the company’s survival. Secondly, they all explain that human capital disclosure enables them to show their employees that the company cares about them. Thirdly, all of the companies explain that human capital disclosure increases the company’s trustworthiness. The Larger Company A explains this in terms of transparency, while the Smaller Company A and the Larger Company B explain this in terms of credibility.

Further, both the Smaller Company A and the Larger Company B claim that other explanations for their human capital disclosure are that it can serve as a marketing tool as well as a recruitment tool. The Larger Company A also gives an indication that they disclose human capital information since it can serve to recruit and retain employees. Moreover, the Larger Company A is the only company to claim that an explanation for their human capital disclosure is the possibility to increase the stakeholders’ understanding of human resource-related questions, since their employees are such an important part of the company’s strategy.

Our empirical findings also show that the companies provide explanations for not disclosing certain information concerning human capital in their annual reports. All of the interviewed companies agree that a main disadvantage with human capital disclosure is that it might harm the company’s competitive position and ruin its human capital investments. Further, all of them claim that it is sensitive to disclose information concerning wage levels. Finally, both the Smaller Company A and the Larger Company A emphasize that by disclosing human capital information the company might jeopardize the integrity of the personnel, and explain that they therefore choose not to disclose certain information.

7.1.2 Does the smaller company give similar and/or different explanations compared to the larger companies?

The companies explanations for their disclosure of human capital do not seem to vary with company size since the companies, in most cases, provide similar explanations. One explanation that does differ between the smaller and the larger companies is that the Smaller Company A mostly discloses human capital information due to tradition. The larger companies, on the other hand, do not provide this explanation. Moreover, all of the interviewed companies also agree on the main reasons not to disclose certain information, which further support our view that the
explanations do not vary with company size. However, one perceived difference between the Smaller Company A and the two larger companies is the fact that both the Larger Company A and the Larger Company B choose to disclose information concerning sick leaves, while the Smaller Company A chooses not to do this since they perceive this information to be sensitive. Despite the minor differences in the explanations provided by the smaller and the larger companies, these differences are not more significant than the ones presented by the two larger companies, which also can be seen as an indication that the explanations do not vary with company size.

7.2 Concluding remarks
We find it obvious that all of the companies address their human capital disclosure to one or more stakeholders, where we find that the employees and customers are the most important ones. From our interviews, we have found that one main explanation provided by the companies regarding why they disclose human capital information is to inform different stakeholders about their most important resource, namely the employees. With this explanation, a clear connection to the stakeholder theory can be seen, since the companies with human capital disclosure aim to convey a positive image of their company to employees and other external parties. We believe that the interviewed companies’ management has realized the need to take care of the relationships with their different stakeholders, since these relationships are key for the company’s success and survival.

When conducting this study, we have found explanations for voluntary disclosure of human capital that indicate tendencies of isomorphism. However, we believe that the companies are influenced by each other to a greater extent than they claim, both consciously and unconsciously. Since six companies dominate the auditing industry in Sweden, those companies logically could be expected to keep track on what their main competitors disclose and not disclose concerning human capital in their annual reports, and hence consciously or unconsciously be influenced by each other. Moreover, we have also found indications that the companies disclose voluntary information on human capital in order to be perceived as legitimate by its stakeholders and society at large. The companies’ human capital disclosure can be seen as a way to increase their trustworthiness and enhance the customers’ confidence in the company, which can be seen as yet another step in the company’s search for legitimacy. To conclude, we believe that companies in the future will have to disclose even more information concerning human capital in order to be perceived as legitimate.

An interesting aspect of this study is that we have found an explanation for not disclosing human capital information in the annual report that the previous research does not mention, namely the risk of jeopardizing the integrity of the personnel and disclosing information that might cause disharmony within the workforce. This new finding might spring from different reasons, and the fact that few qualitative studies have been conducted concerning why companies choose to disclose voluntary information in their annual reports might be a reason why this explanation has not been emphasized by previous research. An additional reason for this can be the fact that Sweden, the country in which the interviewed companies operate, for a long time has been in a prominent position in the development of human capital disclosure and therefore has considered the potential drawbacks with this disclosure more thoroughly than other countries.
As discussed in the analysis, one perceived difference between the smaller and the larger companies is that both larger companies disclose information concerning sick leaves, while the smaller company perceives this information as too sensitive to disclose. This might be due to the fact that both of the larger companies can show a positive trend, that the number of sick leaves is declining, while the smaller company might not have this positive trend and therefore chooses not to disclose, and hence highlight, this information. Despite some minor differences between the smaller and the larger companies’ explanations, we find that the similarities clearly outweigh the differences, and although it has been argued that larger companies disclose more information concerning human capital than smaller ones, the same cannot be said regarding their explanations for this disclosure. To conclude, the companies’ explanations for their disclosure of human capital information do not vary with company size.

When conducting this study, we have found that companies’ human capital disclosure is equally important internally as externally. As mentioned before, human capital information is important to convey to the company’s different external stakeholders, such as customers and regulators. However, it is equally important to convey this message internally, where it can be used to motivate the employees and as a means of control. During our study, we have also found that the benefits with disclosing voluntary information concerning human capital in annual reports outweigh the costs, since all of the interviewed companies choose to disclose this information.

In conclusion, we agree with Mr. Ward when he claims that companies that ignore human capital will go the way of dinosaurs, and we believe that it is essential that companies understand the importance of disclosing as much human capital information as possible. However, this disclosure cannot be made without careful consideration of the potential disadvantages with human capital information.
Chapter Eight: Final Discussion

In this eighth chapter, we will discuss our chosen definition of human capital and other matters that we have thought of while writing this bachelor thesis. In this section we will also give suggestions to future studies.

During this study, we have continuously defined human capital as, “... a combination of factors possessed by individuals and the collective workforce of a firm. It can encompass knowledge, skills and technical ability; personal traits such as intelligence, energy, attitude, reliability, commitment; ability to learn, including aptitude, imagination and creativity; desire to share information, participate in a team and focus on the goals of the organization” (Abeysekera & Guthrie, 2004, p. 253). Now at the end this thesis, we can conclude that the chosen definition was suitable. This since the definition is in consonance with the interviewees’ views on human capital: that it is almost the entire value of the firm, as well as the company’s main source of income and that it consists of, for example, the employees experiences, industry knowledge, competencies and networks.

Another matter that can be discussed is if our study reflects the reality of what the companies actually disclose concerning human capital information, and what reasons the interviewees provide for this disclosure. Worth mentioning is that all interviewed companies provide considerably more human capital information besides what is shown in the annual reports, and since our study has focused on the disclosures made in annual reports we might not have given a true picture of what the companies in reality are showing. Despite this, we still feel that the explanations we have found for why the companies chose to disclose human capital information reflect the reality, and therefore can be applied to all human capital disclosures made by the companies, and not only to those made in the annual report. Another interesting aspect is the fact that all interviewed companies in our study are partner-owned, and hence do not have any investors or analysts to consider. This could imply that the explanations that we have found for the companies’ human capital disclosures cannot be said to apply for all industries. With different firms, from a different industry, additional explanations might be provided.

Looking back at our study, we believe that we have used an appropriate qualitative method in order to conduct the study, and we do not think that another method than interviews would have resulted in more honest and accurate answers. One thing that could have improved this study, would have been conducting all of the interviews in person in order to perceive the interviewees reactions and facial expressions. Unfortunately, this was not always possible because of the distance between some of the interviewees and us, but is one aspect that we would suggest future studies to consider. Furthermore, we suggest that future studies could repeat this study, but focus on another knowledge-intensive industry, such as companies from the IT industry or law firms. The results could then be compared to the results of this bachelor thesis. Additional suggestions for future studies could be to include all of the largest auditing firms in Sweden, or to choose a sample of companies, and for each firm interview both a Human Resource-manager and a COO or CFO in order to see if their answers differ. We also believe that it would be very interesting to
do a comparative study between auditing firms in different countries on why they disclose voluntary information on human capital.
9. References

Book references


Scientific articles


Annual reports

Smaller Company A. Annual report 2010/2011

Larger Company A. Annual report 2010/2011

Larger Company B. Annual report 2010/2011

Larger Company B. Popular version of the annual report 2010/2011

Interviews

Smaller Company A, CA.

Larger Company A, COO/CFO.

Larger Company B, CFO.

Web sources


Other publications


10. Appendix 1

Interview guide – Human capital disclosure in annual reports

1. Please tell us a bit about yourself and your work
   – Academic/professional background

2. What do you think about when you hear the word human capital?

3. What guidelines does your company have regarding voluntary disclosure of human capital?

4. Who decides what information regarding human capital that should be disclosed in your company’s annual report?
   – Why this person/these persons?

5. Why does your company choose to disclose information on human capital in the annual report?

6. For whom does your company disclose this information?

7. What advantages and disadvantages do you perceive with voluntary disclosure of human capital in the annual report?

8. Is there any kind of information that is more sensitive to disclose?
   – Why?
   – Please give examples

9. Is there any kind of information that your company chooses not to disclose?
   – Why?
   – Please give examples

10. Have your company received any positive or negative feedback on the voluntary information that your company provides?
    – From whom?

Thank you in advance!