How might employee benefit arrangements be affected by climate-related risks?

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Companies could see changes in employee benefit arrangements due to site closures or restructurings. Companies may also introduce climate-related performance criteria into employee incentive arrangements or offer climate-related employee benefits – e.g. electric car schemes or bicycle schemes.

What's the issue?

Companies significantly affected by climate-related risks may need to restructure their businesses and/or close certain operating sites. These decisions can have a significant impact on long-term employee obligations (e.g. defined benefit arrangements) and may involve paying termination benefits to large numbers of employees.

Also, companies may amend employee benefit arrangements to align employee behaviour with strategic priorities addressing climate-related risks and opportunities. For example, a company may introduce climate-related performance criteria into employee incentive arrangements or offer employee benefits – e.g. electric car schemes or bicycle schemes.

Accounting for arrangements in the scope of both IFRS 2 *Share-based Payment* and IAS 19 *Employee Benefits* could be affected.

Getting into more detail

How does a company account for employee benefit obligations arising as part of restructurings or site closures?

If a company implements a restructuring plan that includes employee redundancies, then it recognises an expense and a corresponding liability for termination benefits at the earlier of when it:

- recognises a restructuring provision under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* that includes the payment of termination benefits; and
- can no longer withdraw the offer of those benefits. *[IAS 19.165, Insights 4.4.1460]*

A company recognises a restructuring provision when it has a formal plan with sufficient detail about the restructuring and has raised a valid expectation in those affected by the plan – i.e. it has either started to implement the plan or has announced the main features to those affected by it. *[IAS 37.72, Insights 3.12.230]*

In some cases, it can be difficult to determine whether a benefit is a termination or a post-employment benefit. Generally, when an employee is required to perform further services before receiving the benefit, it is more likely to be a post-employment rather than a termination benefit. For example, if as part of a redundancy programme the employee agrees to work a further two years until the site is closed, then any redundancy linked to that service would be treated as a post-employment benefit. The difference in accounting is that a post-employment benefit is attributed over the service period, whereas a termination benefit is recognised in full at the date the obligation arises. *[Insights 4.4.1450]*

Does a company need to update its defined benefit obligation assumptions?

Companies may need to consider the potential impact on estimates, including the actuarial assumptions used in measuring employee benefits. For example, changes may be needed to the actuarial assumptions used in calculating the defined benefit obligations for employees who are made redundant as part of a restructuring.

Are there any new short-term employee benefits?

Short-term benefits are those expected to be settled within 12 months of the related service and can be both monetary and non-monetary. If a company helps to fund energy efficiency improvements to employee homes, provides employees with discounts on purchases of eco-friendly goods or low-interest loans to finance the purchase of an electric car, then these may give rise to short-term benefits recorded in profit or loss. *[IAS 19.9]*

How does a company reflect climate-related performance conditions in the accounting?

To align employee performance with its strategy, a company may introduce incentive plans with climate-related performance criteria.

For share-based payment arrangements, these criteria would generally meet the definition of a non-market performance condition and would not affect the fair value of the share-based payment. Instead, a company incorporates the climate-related condition when estimating the number of awards that it expects to vest. However, if the performance target period extends beyond or commences substantially before any service-related vesting condition, then the climate-related condition is classified as a non-vesting condition and incorporated in the fair value of the award. *[Insights 4.5.420–430]*

For other long-term employee benefits, a climate-related condition is incorporated into the measurement of the liability. We believe that, depending on the specific facts and circumstances, the condition may be incorporated into the measurement of the liability using either a 'most likely' amount or expected value approach. *[Insights 4.4.1405]*

Does a company need to update the measurement and disclosure of plan assets?

A company may need to consider climate-related risks when measuring some plan assets – e.g. a plan may hold real estate assets that could be affected by climate change. *[IAS 19.8, 113]*

Under IAS 19, a company disaggregates the fair value of plan assets into classes that distinguish the nature and risks of those assets, and discloses this in its financial statements. Therefore, companies may need to consider whether they need to update the disaggregation disclosures to reflect climate-related risks and opportunities associated with plan assets – e.g. disaggregation of plan assets into categories (perhaps by industry or sector) that highlight those with significant exposure to climate-related risks and opportunities. *[IAS 19.142]*

Disclosures

Companies need to provide clear and meaningful disclosures about:

- significant judgements and estimates made in recognising and measuring employee benefits; and
- defined benefit plans, including disaggregated disclosure of plan assets.

Actions for management to take now

- Understand the current and potential effect of climate-related risks and opportunities on the company's employee benefit arrangements.

– Determine whether any new obligations have arisen in respect of closure or restructuring plans.

– Assess whether the measurement and disclosure of plan assets appropriately considers significant exposures to climate-related risks.

References to 'Insights' mean our publication **Insights into IFRS**.

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