

Case 10-3

Restructuring Costs

Pharma Co. is a U.S. subsidiary of a U.K. entity that prepares its financial statements in accordance with (1) U.S. GAAP for reporting to its U.S.-based lender and (2) IFRSs in reporting to its parent. Pharma Co. is in the process of restructuring a business line. As part of the restructuring, Pharma Co. is considering the relocation of a manufacturing operation from its present location to a new facility in a different geographic area. The relocation plan would include terminating certain employees.

IAS 37 includes guidance for accounting for restructuring costs in accordance with IFRSs. Paragraph 10 of IAS 37 defines restructuring as follows:

[A] programme that is planned and controlled by management, and materially changes either:

- a. the scope of a business undertaken by an entity; or
- b. the manner in which that business is conducted.

Under IFRSs, emphasis is placed on the recognition of the costs of the exit plan as a whole, whereas under ASC 420-10 (Statement 146) in U.S. GAAP, each type of cost should be examined individually to determine when it should be accrued. As a result, there may be differences in timing of recognition of restructuring costs under IFRSs and U.S. GAAP.

Pharma Co. has taken the following actions:

1. On December 15, 2008, Pharma Co. issued a press release announcing its intentions to terminate the lease of the old facility. The press release is included as Appendix A. Assume the terms of the lease are such that Pharma Co. accounts for the lease as an operating lease. Further, the lease agreement stipulates that written notice is required for early termination.
2. On December 27, 2008, Pharma Co. management communicated the main features of a one-time, nonvoluntary termination plan to its employees. The communication to the employees is included as Appendix B.
3. Pharma Co. will incur a relocation cost of \$500,000 and staff training cost of \$1.5 million. Further, Pharma Co. has entered into irrevocable contracts with certain other relevant parties to affect the restructuring plan over the following 18 months.
4. The cost to dismantle the existing manufacturing operation is estimated to be \$1 million. In the jurisdiction in which Pharma Co. operates its current facility, there is no legal obligation for dismantling plants when abandoned. Pharma Co. has not historically dismantled its plants when abandoned but decided to make an exception.

The company has, in a press release, stated its intention to dismantle the existing operation. The costs to reassemble the operation in the new facility have not yet been finalized.

Required:

- In reporting to its U.K. parent under IFRSs, how should Pharma Co. account for the above restructuring program for the year ended December 31, 2008?
- In reporting to its U.S.-based lender in accordance with U.S. GAAP, how should Pharma Co. account for the restructuring program for the year ended December 31, 2008?

APPENDIX A

Press Release

Pharma Co. Announces Early Lease Termination

Tulsa – 12/15/2008 – Pharma Co., a leading pharmaceutical developer, today announced its plan to terminate the lease on its Plant A facility located in Bellvue, Oklahoma, as part of its management restructuring and cost-cutting measures. Earlier today, Pharma Co. entered into an oral agreement with the lessor to terminate the lease. The lease termination fee is \$1.3 million.

The lease agreement was originally entered into in February 2002 and provided for Pharma Co. to occupy 100 percent of a 146,300-square-foot building in the Bellvue area of Tulsa with a term of 10 years.

Pharma Co. plans to vacate the Plant A facility on January 31, 2009, at which time it will sign the lease termination agreement.

APPENDIX B**Inter-Office Memorandum****To: All Employees of Pharma Co.****From: Gregory Seagate, Director, Human Resources******For internal distribution only****

December 27, 2008

Today, the leaders of Pharma Co. have determined to discontinue the research and development of our line of Live4mor drugs, which was initially publicized as the company's response to the market place's demand for more drugs embodying the latest in anti-aging drug technologies.

As a result of management's decision to eliminate its activities pertaining to the Liv4mor line of drugs, we will be implementing a one-time nonvoluntary termination plan to reduce our workforce. Although management has not yet identified the specific employees to be terminated, the current restructuring plan involves a reduction of approximately 120 employees, which represents 10 percent of our workforce. The workforce reduction is expected to be completed by January 31, 2009, and is expected to cost approximately \$2 million.

Our president and chief executive officer, Catherine Smith, made the following remarks this morning, "The restructuring plan that we are announcing today is a painful but unavoidable action given the change in the company's priorities and the competition in the market place. While we are still a financially strong company, the restructuring plan will better prepare us for the future."

Decisions will be communicated as soon as possible. In the meantime, please feel free to contact me with any questions or concerns.

Gregory