Case 15-6
Targeted for Termination

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

Pharma has taken the following actions:

1. On December 27, 20X1, Pharma management communicated the main features of a one-time, nonvoluntary termination plan to its employees. The communication to the employees is included as Appendix A. Receipt of this one-time termination benefit is contingent on employees' continued service through the date Pharma ceases production and closes its Plant A facility. The Company estimates that the one-time termination benefit is $2.5 million. In addition, Pharma has a historical practice of providing two weeks' severance to individual employees upon nonvoluntary termination. The Company estimates that the cost of two weeks' severance for affected employees is $500,000. Finally, in accordance with the facility manager's employment agreement, the facility manager will receive an additional lump-sum benefit of $50,000 upon closure of the facility. Given the insignificant time between the date of the communication and the date the employees will be terminated, the Company is assuming that fair value of the costs listed above equals the estimated amounts.
2. Pharma will incur a relocation cost of $500,000 and staff training cost of $1.5 million. Further, the Company has entered into irrevocable contracts with certain other relevant parties to affect the restructuring plan over the ensuing 18 months.
3. On December 29, 20X1, Pharma issued a press release announcing its intentions to terminate the lease of its present facility, incurring an early termination fee in addition to its normal rental payments through the date of termination. The press release is included as Appendix B. Assume the terms of the lease are such that Pharma accounts for the lease as an operating lease. Further, the lease agreement stipulates that written notice in the form of a letter or e-mail from Pharma directly to the lessor is required for early termination.

Required:

- How should Pharma account for its restructuring costs in its IFRS financial statements as of and for the year ended December 31, 20X1?
- How should Pharma account for its restructuring costs in its U.S. GAAP financial statements as of and for the year ended December 31, 20X1?

In answering these questions, students should provide an analysis of how Pharma should account for (1) employee benefits, (2) lease termination costs, and (3) retraining and relocation costs.

Appendix A

Inter-Office Memorandum

To: All Employees of Pharma Co.

From: Gregory Seagate, Director, Human Resources

For internal distribution only

December 27, 20X1

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

As a result of management's decision to eliminate its activities pertaining to the Liv4mor line of pharmaceuticals, we will be implementing a one-time, nonvoluntary termination plan to reduce our workforce. Although management has not yet identified which employees will be terminated, the current restructuring plan involves a reduction of approximately 120 to 125 engineering, facility management, and operational management employees of the 140 employees that currently work at the Plant A facility in Bellevue, Oklahoma, which represents 10 percent of our total workforce. To support our employees during this difficult time, the Company will be offering a one-time termination benefit to employees, consisting of 10 weeks' pay in addition to our historical practice of providing two weeks' pay to employees involuntarily terminated for non-performance-related reasons, for a total benefit of 12 weeks' pay. Receipt of the one-time termination benefit is contingent on continued service through the date the Company closes the facility. The workforce reduction is expected to be completed by January 31, 20X2.

Our president and chief executive officer, Scott B. Streaser, 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 marketplace. 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

Appendix B

Press Release

Pharma Co. Announces Early Lease Termination

Tulsa, OK, December 29, 20X1 — Pharma Co., a leading pharmaceutical developer, today announced its plan to terminate the lease on its Plant A facility located in Bellevue, 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 2006 and stipulated that Pharma Co. would occupy 100 percent of a 146,300-square-foot building in Bellevue for a term of 10 years.

Pharma Co. plans to vacate the Plant A facility on January 31, 20X2, at which time it will sign the lease termination agreement.