

# Pensions update – Spain

New Spanish GAAP effective 1 January 2008

On 16 November 2007 new legislation was enacted in Spain which introduced the new 'Plan General de Contabilidad' (PGC), in effect a new Spanish GAAP (set of Generally Accepted Accounting Principles).

The new PGC is applicable for all accounting periods beginning on or after 1 January 2008 and replaces the old Spanish GAAP, or PGC, of 1990.

This factsheet provides an update on the accounting for long-term employee benefit liabilities under the new PGC, and specifically the accounting for defined benefit (DB) pension and other post employment benefit liabilities. We will also comment on some other general aspects of the new PGC.

## Summary

Organisations with operations in Spain are strongly advised to begin early discussions with their local consultants and auditors in order to fully understand the implications of the new PGC on the valuation and accounting of their DB plan liabilities.

Although, on the surface, the accounting for DB liabilities under the new PGC appears **similar** to that under IAS 19 (the International Accounting Standard on 'employee benefits'), in practice it could differ substantially.

While for some organisations the impact of the new PGC may be limited, for others it could be material, and require new or additional year end actuarial valuation and accounting work.

The view of the auditor is likely to play a major role, in particular, as to whether existing accounts on an alternative GAAP (for example IAS 19) can be considered 'equivalent' to the new PGC. The way in which organisations raise this issue with their auditors could be critical in order to avoid duplication of work and potential accounting issues.

The remainder of this factsheet provides more detailed information on this subject.



## New PGC

Following the 2005 mandatory adoption of IAS by **all** European listed entities, the new PGC is Spain's next step towards convergence with IAS for all organisations, whether listed or unlisted.

The new PGC is, with a few exceptions, of mandatory use for all Spanish organisations. The more notable exceptions are:

- SMEs (Micro, Small & Medium Sized Enterprises, as defined in Spanish legislation) – which may use an alternative abbreviated version of the new PGC.
- Financial institutions (banks and insurance companies in particular) – which may continue to use the specific Spanish GAAPs (also variants of IAS) applicable to them.

Two points worth noting regarding first time adoption of the new PGC are:

- 'Equivalent' GAAP – to the extent that an entity has already been preparing historic accounts using IAS or a similar GAAP, they could continue to be admissible under the new PGC, provided that the methodology employed can be deemed 'equivalent' to that required under the new PGC. Unfortunately, the new PGC does not define 'equivalent'. This is likely to be a key issue for some organisations and, more importantly, their auditors.

- Transition – the default transition date will be the start date of the first accounting period beginning on or after 1 January 2008, without the need to provide prior year comparative accounts under new PGC. However, organisations can voluntarily elect to provide prior year comparative accounts under the new PGC, in which case the transition date would be the start date of the prior year accounting period. Transition impacts will generally be dealt with through a one time balance sheet adjustment.

## Old PGC on pensions and similar obligations

Accounting for pensions and similar obligations under the old PGC (1990) was largely non prescriptive, the only guidance given being limited to one paragraph:

"...the cost of pensions and similar obligations includes the accrued charges, estimated on the basis of actuarial calculations, required for the purpose of making the necessary provision for the legal or contractual liabilities..."

As a result many Spanish companies have historically accounted for DB pensions on a cash/contribution basis, that is, they do not hold an accounting provision (balance sheet liability) for pensions in their local Spanish books.

However, some organisations may have historically used alternative methodologies to determine a

pension provision for their local Spanish books, for example:

- Spanish listed companies will have accounted for pensions using IAS 19 since 2005.
- Spanish subsidiaries of European listed (non-Spanish) multinationals may have accounted for pensions on an IAS 19 basis.
- There may also be instances of Spanish subsidiaries of US multinationals which have accounted for pensions on a US GAAP basis.

Auditors will likely need to consider to what extent existing accounts can be deemed 'equivalent' to the requirements of the new PGC.

## New PGC on long-term defined benefit liabilities

The valuation and accounting of long-term DB liabilities is covered in part two, paragraph 16.2, of the new PGC.

The text of paragraph 16.2 extends to less than a page and, very loosely speaking, could be described as a **condensed** version of IAS 19 – most of it being extracts of key paragraphs from IAS 19.

New PGC therefore shares many similarities with IAS 19, including, in particular:

- Similar fair value approach to the valuation of pension plan assets.
- Similar definitions of pension plan assets and reimbursement rights.

“ The new PGC is, with a few exceptions, of mandatory use for all Spanish organisations. ”

- Similar approach to determining the balance sheet pensions liability/asset, including the concept of an asset ceiling (limit on balance sheet pre-paid) and unrecognised (non-vested) past service costs.
- Similar concept of pension expense, including service cost, interest cost and expected return components.

However, while new PGC shares some of the key elements of IAS 19, there are also some notable differences – see Figure 1.

**Figure 1** | Some key differences between IAS 19 and new PGC (part two, paragraph 16.2)

	IAS 19	New PGC (part two, paragraph 16.2)
<b>Actuarial assumptions</b>	Unbiased and mutually compatible, financial assumptions based on market expectations at balance sheet date.	Unbiased and mutually compatible, but no explicit reference made to market based approach to financial assumptions.
<b>Actuarial valuation method</b>	Explicitly prescribes the use of the Projected Unit Credit (PUC) actuarial valuation method.	Requires the use of 'actuarial methods' to value obligations, but does not prescribe a specific method.
<b>Recognition of actuarial gains and losses</b>	Organisations can choose between: <ul style="list-style-type: none"> <li>■ immediate or deferred recognition through profit and loss account; or</li> <li>■ immediate recognition outside profit and loss account, and through an adjustment to equity (recorded in the SORIE, 'Statement of Recognised Income and Expense').</li> </ul>	Mandatory immediate recognition outside profit and loss, and through an adjustment to net equity (recorded against reserves).
<b>Asset valuation methodology</b>	'Fair value' of assets, but provides additional guidance on situations where this could differ from market value, in particular where there are insurance contracts matching some/all of the liabilities (relevant to many Spanish plans).	'Fair value' of assets, but provides no specific guidance on situations where this could differ from market value, in particular where there are matching insurance contracts.
<b>Settlements and curtailments</b>	Provides specific guidance on the accounting for settlements and curtailments, the effect of which would normally impact the profit and loss account.	Does not provide explicit guidance on settlements and curtailments, therefore, in theory, any impact could potentially be recognised outside profit and loss (although part II of the introduction to the PGC appears to contemplate recognition through profit and loss).

Therefore, while on the surface the new PGC appears to be based on IAS 19-like principles, when looked at more closely, the valuation and accounting for pensions under new PGC and IAS 19 could differ substantially.

A couple of tentative conclusions that could be drawn from this are:

- Where IAS 19 historic accounts already exist, and these are based on immediate recognition of actuarial gains/losses outside the profit and loss account (through SORIE), it is likely that auditors will deem those to be 'equivalent' to the requirements of the new PGC.
- Where IAS 19 historic accounts already exist, but these are based on recognition of actuarial gains/losses through the profit and loss account, auditors may deem those not 'equivalent' to the requirements of the new PGC, and therefore require that alternative accounting disclosures be prepared which are compliant with the new PGC.

To stress the point made earlier – the way in which organisations raise this issue with their auditors could be critical in order to avoid duplication of valuation/accounting work and potential accounting issues.

## Next steps

In light of the above, we recommend that organisations with operations in Spain:

- Review their current local pensions accounting treatment.
- Explore with their local consultants and auditors whether their current accounting treatment can be considered 'equivalent' to the new PGC.
- Identify the additional work (if any) that may be required to comply with the new PGC.

## Further information

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