Accounting and reporting when in reorganization under Bankruptcy Code

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September 2020

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1. Introduction and background

Most accountants hope to never have reason to consider the accounting guidance that applies to entities undergoing bankruptcy proceedings. Unfortunately, due to the widespread and significant impact of the COVID-19 pandemic on businesses, the number of bankruptcy filings has risen significantly in 2020, and the effects of the pandemic could continue to be felt for years to come. That said, filing for bankruptcy may give entities the *fresh start* they need to continue to operate and grow in the future, unencumbered by significant debt or liabilities accumulated during the pandemic.

There are various forms of bankruptcy, but the one that is most commonly utilized by a business is referred to as a Chapter 11 proceeding. Bankruptcy law was codified by a federal statute, enacted October 1, 1979, as title 11 of the United States Code by the Bankruptcy Reform Act of 1978 (Bankruptcy Code). The Bankruptcy Code applies to all cases filed on or after its enactment and provides the basis for the current federal bankruptcy system.

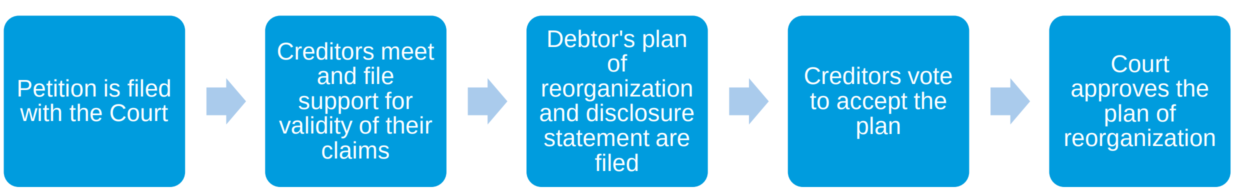
A Chapter 11 proceeding is a reorganization action, either voluntary or involuntary, initiated under the provisions of the Bankruptcy Code, that provides for a reorganization of the debt and equity structure of the business to allow the business to continue operations. Entities undergoing a reorganization under Chapter 11 are within the scope of ASC 852-10, *Reorganizations – Overall*. This white paper provides accounting and financial reporting guidance for entities that have filed petitions with the Bankruptcy Court and expect to reorganize as going concerns under Chapter 11, as well as entities that have emerged from Chapter 11 (emerging entities) under confirmed plans. The guidance in this white paper should also be followed for prepackaged bankruptcies (i.e., those where the bankruptcy plan has been confirmed prior to filing under Chapter 11).

In some cases, a debtor may file a plan of liquidation under Chapter 11 or file a bankruptcy proceeding under Chapter 7, which results in a liquidation, voluntary or involuntary, initiated under the provisions of the Bankruptcy Code. Entities that liquidate or adopt plans of liquidation under the Bankruptcy Code should follow the guidance in ASC 205-30, *Presentation of Financial Statements – Liquidation Basis of Accounting*, which is not addressed in this white paper.

Entities that restructure their debt outside Chapter 11 are also outside the scope of this white paper. For additional guidance on accounting for debt modifications, refer to our guide, Fundamentals of accounting for debt modifications and restructurings.

2. Overview of Chapter 11 proceedings

Bankruptcy proceedings begin when an entity files a petition with the Bankruptcy Court, an adjunct of the United States District Courts. The Bankruptcy Court is generally responsible for cases filed under Chapters 7, 11, 12 and 13 of the Bankruptcy Code. The overall flow of a standard Chapter 11 bankruptcy proceeding is as follows:



The ultimate goal of bankruptcy proceedings is to protect the interests of creditors and investors, which are referred to as *parties in interest*. Under Chapter 11, this is generally done by developing an economically viable plan of reorganization, which outlines the treatment of all the assets and liabilities of the debtor. The filing of the petition starts the reorganization proceeding, which lasts until a reorganization plan is confirmed. The goal is to develop a plan that will enable the entity to continue operations and thereby maximize the recovery by the entity's creditors and shareholders. To that end, a plan of reorganization generally includes the forgiveness of significant outstanding debts, often in exchange for equity interests in the newly reorganized entity. For a plan to be approved by the Court, it must not only be deemed feasible, but must also be considered to be in the best interests of the creditors. More specifically, for the plan to be confirmed and the reorganization proceedings thereby concluded, the consideration expected to be received by parties in interest under the plan must exceed the consideration they would otherwise receive on liquidation of the entity under Chapter 7 of the Bankruptcy Code.

The plan of reorganization is generally prepared by the debtor, who has the exclusive right to file a plan for the first 120 days after the petition is granted. If a plan is filed within the exclusive period, an additional 60 days is provided to allow the debtor to obtain plan acceptance from the creditors, equity owners and any other parties in interest. These periods are the standard timeline, but can be shortened or lengthened by the Court after a hearing at the request of either party. If the debtor fails to file a plan of reorganization within the required time frame, any creditor, trustee or other interested party may submit its own plan for consideration by the Court.

Once the Court confirms the plan it will set an effective date for emergence. The effective date is also referred to as the emergence date and can be a specified date or the date when all material conditions outlined in the plan are met.

From the date of the initial filing of the petition until the emergence date, existing management generally continues to operate an entity that has filed a petition under Chapter 11. During this time, the entity is referred to as a *debtor-in-possession*. The debtor-in-possession is allowed to operate the business and make decisions to engage attorneys, accountants, advisors or other professionals to assist it during its bankruptcy case. The operation of the business remains in the hands of the debtor-in-possession in all Chapter 11 cases unless the Court authorizes the appointment of a trustee. This is very rare and is generally limited to instances of fraud, gross negligence or incompetence. The appointment of a trustee immediately terminates the debtor's exclusive right to file a plan, and any party in interest may then do so.

In addition to the plan of reorganization, a disclosure statement is also prepared and must be presented to the parties in interest before they can vote to accept or reject the plan. The disclosure statement includes whatever additional information the Court deems to be necessary for the parties to make a reasonably informed judgment of the plan.

The Court approved disclosure statement and reorganization plan are provided to the claim holders to vote on. Claim holders are usually classified as either secured creditors, unsecured creditors with priority, general unsecured creditors or equity holders. Each class of claim holders votes independently, as a class, to accept or reject the plan. For an individual class of claim holders to be deemed to accept the plan, at least two-thirds of the dollar amount of allowed claims in the class, and more than one-half in number of the allowed claims in the class, must approve the plan.

Once the vote has occurred, the Court will decide whether to confirm the plan and set the effective date for emergence. The Court may confirm a plan even if some classes of creditors or some of the stockholders have not accepted it under cram-down provisions (see Section 2.1.1).

2.1. Plan of reorganization

The course of the reorganization proceedings and the future operations of the debtor are driven by the plan of reorganization. The plan outlines the treatment of all creditors and equity holders and shapes the financial structure of the emerging entity. It creates a binding agreement between the debtor and any other parties in interest. In general, except for those claims and rights explicitly protected by the provisions of the plan, confirmation of the plan discharges the debtor from all preconfirmation claims and terminates all rights and interests of equity security holders or general partners as provided for in the plan.

According to ASC 852-10-05-8, the Bankruptcy Court confirms a plan if it finds all of the following:

a. The plan and the plan proponent have complied with various technical requirements of the Bankruptcy Code.

b. Disclosures made in soliciting acceptance of the plan have been adequate.

c. Dissenting members of consenting classes of impaired claims would receive under the plan at least the amount they would have received under a Chapter 7 proceeding.

d. Claims entitled to priority under the Bankruptcy Code will be paid in cash.

e. Confirmation of the plan is not likely to be followed by liquidation or further reorganization.

f. At least one class of impaired claims, apart from insiders, has accepted the plan.

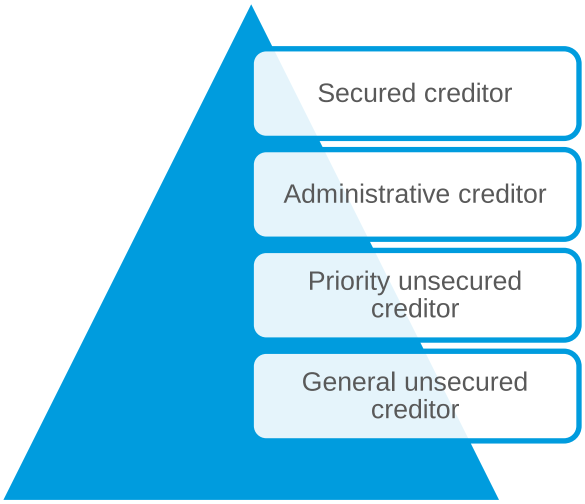
g. The plan proponent has obtained the consent of all impaired classes of claims or equity securities, or the plan proponent can comply with the cram-down provisions of the Bankruptcy Code. Under the cram-down provisions, the court may confirm a plan even if one or more classes of holders of impaired claims or equity securities do not accept it, as long as the court finds the plan does not discriminate unfairly and is fair and equitable to each nonconsenting class impaired by the plan.

To avoid some of the administrative burden and costs involved in operating as a debtor-in-possession, some entities will wait to file for bankruptcy until they have already prepared a plan of reorganization. Some even obtain approval of the plan from their creditors and equity holders before filing with the Court. These are referred to as prearranged or prepackaged bankruptcy filings. While this can speed up the process, the legal requirements for confirmation by the Court are the same, which means that the accounting for prearranged and prepackaged bankruptcies does not differ from a standard Chapter 11 bankruptcy and is within the scope of ASC 852.

2.1.1. Cram-down provisions

Generally, for a plan to be confirmed, it must be accepted by all impaired classes of claims or equity securities. However, as previously mentioned, under certain conditions, the Bankruptcy Code allows the Court to confirm a plan even though an impaired class has not accepted the plan. Cram-down provisions allow for a plan to be confirmed without the approval of an impaired class if the plan does not discriminate unfairly and is fair and equitable to each nonconsenting class impaired by the plan. To conclude that a nonconsenting class is not impaired by the plan, the absolute priority doctrine is applied. This doctrine states that all members of the senior class of creditors and equity interests must be satisfied in full before the members of the second senior class of creditors can receive anything, and the full satisfaction of that class must occur before the third senior class of creditors may be satisfied, and so on.

In general, the creditors fall into four main classes—secured, administrative, priority unsecured, and general unsecured. Classes may be further broken down by the reorganization plan, but generally fall into these four categories, which are listed in the usual order of priority for payment:



- A secured creditor holds a claim that is backed by assets of the debtor (collateral).
- Administrative creditors hold claims generated during the post-petition period of the bankruptcy proceedings. These include claims from professionals engaged to assist in the bankruptcy process as well as vendors who delivered inventory to the debtor within 20 days of the filing.
- Priority unsecured creditors hold claims that are specifically entitled to priority over unsecured claims, and typically include things like wages, benefits and critical supplies.
- All other creditors that do not fall into one of the preceding categories are considered general unsecured creditors and typically hold claims to general trade payables and other unsecured debts.

No payments can be made to a subordinate class unless the preceding class has been either paid in full or otherwise settled in a fair and equitable manner. A secured claim is deemed to be treated fairly and equitably if it remains adequately collateralized and will receive a stream of payments whose discounted value equals the amount of the secured claim on the effective date of the plan. An unsecured claim (administrative, priority unsecured or general unsecured) is deemed to be treated fairly and equitably if either:

- It receives assets whose discounted value equals the allowed amount of the claim.
- The class below it will not receive or retain any assets under the plan.

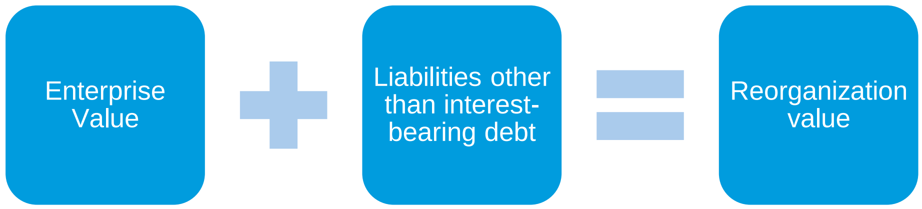
Similarly, an equity security interest is deemed fairly and equitably treated if either:

- That interest receives assets whose discounted value equals the greatest of any fixed liquidation preference, any fixed redemption price or the value of such interest.
- No junior equity security interest will receive any assets under the plan.

2.2. Reorganization value

As part of the bankruptcy proceedings, the Court will generally approve a reorganization value, or range of values. The reorganization value approximates the fair value of the entity that emerges from bankruptcy before considering liabilities and serves as the basis for applying fresh-start accounting. In other words, it represents the amount a buyer would pay for the assets of the entity immediately after restructuring. ASC 852-10-05-10 defines reorganization value as “the amount of resources available and to become available for the satisfaction of postpetition liabilities and allowed claims and interest, as negotiated or litigated between the debtor-in-possession or trustee, the creditors, and the holders of equity interests.” This amount can be calculated using a variety of methods, but is generally based on a discounted cash flow model.

The reorganization value differs from the business enterprise value. Reorganization value only includes the value of the assets that will be held by the reconstituted entity and those assets held by the debtor that will be disposed of under the reorganization plan. The enterprise value, on the other hand, is the fair value of the interest-bearing debt and shareholders’ equity of the entity and is usually calculated by a valuation specialist as part of the bankruptcy proceedings. This amount may also be referred to as the *market value of invested capital* or *total invested capital*. The reorganization value can usually be calculated from the enterprise value by adding back liabilities other than interest-bearing debt (i.e., working capital liabilities and other liabilities).



That said, enterprise value will often not include the value of cash and any noncore assets and liabilities of the enterprise, which could result in additional reconciling items to be included in this calculation. For example, assets and liabilities that are not included in the reconstituted entity are often excluded from the enterprise value. These could be assets that will be sold off during reorganization or legacy pension costs or environmental liabilities that are not carried forward. Tax credits and net operating loss carryforwards are also often excluded from the enterprise valuation. To determine whether adjustments are needed for these items, entities should carefully review the valuation report to determine whether or not they were included in the cash flows used to calculate the enterprise value.

2.3. The disclosure statement

In addition to preparing the reorganization plan, debtors filing for Chapter 11 bankruptcy are also required to file a disclosure statement. The disclosure statement is a document that provides creditors with adequate information about the debtor's financial position to enable them to make an informed decision on whether to accept or reject the reorganization plan. The debtor prepares the disclosure statement and then submits it to the Court for approval. Once the Court approves the document, it is distributed to the creditors. The statement must be distributed to the creditors prior to calling for a vote on the reorganization plan.

The Bankruptcy Code requires that the disclosure statement include adequate information, but does not specifically identify the required information. Rather, it defines adequate information as information that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan, as far as it is reasonably practicable to provide in light of the nature and history of the emerging entity and the condition of the emerging entity's records. The exact nature of the information varies based on the nature, history and size of the debtor, as well as the sophistication of the creditors or equity holders required to approve the plan. Examples of the kinds of items that may be included in disclosure statements include:

- History of the entity
- Summary of the reorganization plan
- Description and value of the debtor's assets
- Description of claims and liabilities and how they are treated in the plan
- Historical and prospective financial information
- Pro forma balance sheet reporting the reorganization value and the capital structure of the emerging entity
- Comparison with Chapter 7 liquidation

While not required, in most cases, a valuation will be performed by a third party and included in the disclosure statement. In general, the only exception to this is when either reorganization value of the emerging entity is greater than the liabilities, or when holders of existing voting shares retain more than 50% of the emerging entity's voting shares.

3. Financial reporting during Chapter 11 reorganization proceedings

While filing for bankruptcy and entering a reorganization proceeding is a significant event, it does not generally have a significant effect on the preparation of an entity's financial statements while the reorganization is in process. U.S. generally accepted accounting principles (GAAP) continue to be applied much as they always have been. That said, the needs of financial statement users do change as a result of an entity filing for bankruptcy, which means some changes to financial reporting are necessary. One of the primary objectives of financial reporting for entities that are in the midst of a Chapter 11 reorganization is to distinguish between the activities that are part of the normal operations of the entity and those that are specific to the reorganization proceeding. Additionally, all financial statements issued between the petition date and the emergence date should be labeled as *debtor-in-possession* to clearly indicate the status of the entity.

The following sections provide detailed explanations on how each of the financial statements should be presented for entities that were undergoing a reorganization proceeding during the reporting period to clearly identify activities associated with the reorganization proceeding. See Appendix A for illustrative financial statements and disclosures for an entity operating under Chapter 11.

3.1. Balance sheet

During a reorganization proceeding, assets continue to be accounted for under *normal* U.S. GAAP, which means they should continue to be evaluated for potential impairment and writedowns taken if and as required by the applicable guidance. Liabilities, on the other hand, are generally grouped into the following three categories: (a) prepetition liabilities subject to compromise, (b) prepetition liabilities not subject to compromise and (c) postpetition liabilities.

3.1.1. Prepetition liabilities subject to compromise

Prepetition liabilities include all liabilities that were incurred by an entity prior to filing a petition for protection under the Bankruptcy Code. These liabilities should then be further evaluated to determine whether they are: (a) *subject to compromise*, meaning there is a possibility they may not be settled at the full claim amount under the reorganization plan, or are (b) *liabilities not subject to compromise*. Prepetition liabilities subject to compromise should be clearly distinguished on the balance sheet as separate from prepetition liabilities not subject to compromise and postpetition liabilities. Typically, the majority of an entity's liabilities (for example, trade payables and unsecured debt) will fall into the *subject to compromise* category during a reorganization proceeding.

Liabilities subject to compromise generally include liabilities that are not fully secured (i.e., the value of the underlying collateral is less than the claim). If there is any doubt that the value of the collateral securing the claim is sufficient or that the claim will be impaired under the plan, the entire amount of the claim is included in liabilities subject to compromise. For example, if outstanding debt of $200,000 is secured by a building valued at $180,000, the entire $200,000 liability should be included in liabilities subject to compromise, not just the $20,000 unsecured portion.

Liabilities that may be affected by the plan should be reported at the amounts expected to be allowed, even if they may be settled for lesser amounts. Most allowed claims are reported by the debtor in its initial listing of liabilities filed with the Court. Claims not included in the initial listing can be submitted by a creditor. If the debtor accepts or does not object to the creditor's claim it is considered an allowed claim. If the debtor contests the validity of the claim or its amount, it is reviewed by the Court, which determines whether the claim is valid and at what amount. Once the Court approves the contested amount of the claim it is considered an allowed claim. As a result of these and other factors, the expected allowed claim amounts may change. The amounts recorded in the financial statements are determined in accordance with ASC 450-20, *Loss Contingencies* and should be the best estimate as of the reporting date. Claims that can't be reasonably estimated should be disclosed in the financial statements. The best estimate recognized in the financial statements may change in subsequent periods based on actions of the Court or as new information becomes available. The full amount of the expected allowed amount should be recorded as a liability subject to compromise unless the Court approves a portion of the invoice for payment, at which point only the approved portion should be reclassified to prepetition liabilities not subject to compromise.

The expected *allowed* amount of the claim is the amount that management expects the Court will approve as a valid claim. This differs from the expected *settlement* amount, which is the amount expected to ultimately be paid to the creditor. Consider the following example.

Example: Expected allowed amount vs. expected settlement amount

A supplier submits a claim to the Court for a $100 invoice it believes was erroneously excluded from the initial listing of liabilities. The debtor investigates the claim and discovers the invoice was excluded as it was questioning the amount at the time of the filing. The debtor believes the invoice was overstated and that it owes only $80 as there was a $20 credit from a prior payment that should have been applied to the invoice. Because the debtor believes the claim to be valid, but expects that the Court will agree with its assessment that the amount billed should have been $80, the expected allowed amount is $80. As a result of the bankruptcy proceedings, the debtor expects to settle this same invoice for 50 cents on the dollar. The expected settlement amount is, therefore, $40.

Because the amounts recorded in the financial statements should be the best estimate of the allowed amount (that is, the expected allowed amount) as of the reporting date, the entity should record $80 as a liability subject to compromise.

In the following reporting period, the Court approves the $80 as an allowed claim. Additionally, the Court determines that some level of payment to the supplier is critical to the continued operation of the entity and approves $30 of the original invoice for payment. Because the $30 is no longer subject to compromise, the entity should report $30 as a prepetition liability not subject to compromise and leave the remaining $50 in liabilities subject to compromise until the plan is confirmed or the Court approves additional payments during the proceedings.

When determining the allowed amount for debt subject to compromise, special attention should be given to the treatment of discounts, premiums and debt issuance costs, which are considered as valuations of the related debt. ASC 852-10-45-6 indicates that when debt subject to compromise becomes an allowed claim, a gain or loss for the difference between the allowed claim and the carrying amount of the debt should be recorded as a reorganization item in the income statement and any existing discounts, premiums or deferred issuance costs should be adjusted to the extent necessary to report debt at the allowed amount. ASC 852-10 does not indicate whether debt that has not yet been explicitly allowed by the Court should be adjusted to its expected allowed amount. As a result, two approaches are commonly used in practice:

- Adjust the debt to the expected allowed amount when it is probable that the Court will allow the claim and the amount is reasonably estimable.
- Adjust the debt to the allowed amount when the Court formally allows the claim.

The total amount of liabilities subject to compromise should be separately presented as a single caption on the balance sheet, rather than segregated between current and noncurrent. The single caption for liabilities subject to compromise is classified outside of current liabilities because the Bankruptcy Code typically results in many prepetition claims not being allowed to be paid until after the reorganization plan has been confirmed. The timing of such confirmation in most cases cannot be predicted. The principal categories of the liabilities subject to compromise are then disclosed in the notes to financial statements (See Note Y in Section 4 of Appendix A).

3.1.2. Prepetition liabilities not subject to compromise

Liabilities not subject to compromise are prepetition liabilities that are fully secured, and therefore, expected to be settled in full. These liabilities continue to be accounted for as they were prior to the entity filing for bankruptcy. When a classified balance sheet is presented, liabilities not subject to compromise should continue to be segregated into current and noncurrent classifications in accordance with other applicable U.S. GAAP. For additional information, refer to our white paper, Fundamentals of Debt Classification.

3.1.3. Postpetition liabilities

Postpetition liabilities are incurred subsequent to the filing of a petition. Liabilities incurred subsequent to filing a petition are approved by the court and generally continue to be paid throughout the bankruptcy process. Examples of liabilities generally approved to be incurred are professional fees for services related to the bankruptcy proceedings or payments to critical vendors that allow the debtor-in-possession to continue to operate. Debtor-in-possession financing may also be approved if the arrangement is deemed critical for the continued operations of the debtor.

Postpetition liabilities are presented separately from prepetition liabilities subject to compromise and classified as current or noncurrent consistent with other applicable U.S. GAAP. For additional information, refer to our white paper, Fundamentals of Debt Classification.

3.2. Income statement

The income statement should separately present the results of ordinary operations from reorganization items while the entity is in Chapter 11 proceedings, unless the reorganization items would otherwise be required to be reported as discontinued operations in accordance with ASC 205-20, *Presentation of Financial Statements – Discontinued Operations*. Reorganization items normally include professional fees and similar types of expenditures directly related to the Chapter 11 proceedings, as well as realized gains and losses and provisions for losses resulting from the restructuring of the business as determined in accordance with other applicable U.S. GAAP. It is not appropriate to defer, or capitalize, professional fees and similar types of expenditures incurred during the Chapter 11 proceedings, nor is it appropriate to accrue professional fees and similar types of expenditures upon the filing of the Chapter 11 petition that have not yet been incurred. In other words, professional fees relating to the Chapter 11 proceeding should be expensed as incurred and reported as reorganization items in the income statement.

Interest expense is not considered to be a reorganization item and should be recorded only to the extent that either: (a) it will be paid during the Chapter 11 proceeding or (b) it is probable that it will be an allowed claim. This is unlikely to be the case for interest related to any unsecured claim as the Bankruptcy Code specifically precludes the payment of interest on unsecured claims unless there is a surplus and all unsecured claims will be paid in full. Interest on secured claims is only allowed to the extent that the value of the collateral exceeds the principal of the debt, meaning the interest is secured.

The difference between recognized interest expense and the stated contractual amount of interest should be disclosed. This disclosure is important because interest does not accrue on unsecured claims during the proceeding if the entity is insolvent (the sum of the entity's debts is greater than the fair value of the entity's property). SEC registrants should make this disclosure parenthetically on the face of the income statement. Other entities may choose to make this disclosure on the face of the income statement or in the notes to the financial statements.

Interest income that is earned as a result of the proceeding should be reported as a reorganization item. Normally, all interest income should be considered a reorganization item because it is typically earned on cash that accumulated during the proceeding when the entity was not paying its obligations. We believe if management can reasonably estimate that portion of interest income applicable to normal invested working capital, then it should be reported in the ordinary manner.

3.3. Cash flow statement

Reorganization items should be separately reported in the operating, investing and financing categories of the cash flow statement. The direct method is preferred, but not required. If the indirect method is used, the entity must also disclose details of operating cash receipts and payments resulting from the reorganization in either a supplementary schedule or in the notes to the financial statements.

3.4. Consolidated financial statements

When a majority-owned subsidiary entity files for bankruptcy and the parent does not, ASC 810-10-15-10 indicates that the parent cannot consolidate the subsidiary because it no longer controls the entity. Accordingly, when a subsidiary files for bankruptcy, it is usually appropriate for a solvent parent to deconsolidate the subsidiary and account for its investment in the subsidiary at fair value. The equity method of accounting usually should not be used to account for the formerly-consolidated subsidiary because the bankruptcy filing usually results in the parent no longer having significant influence over the investee. In some rare cases, the equity method may be used if the parent is deemed to have significant influence over the subsidiary, for example if the parent company operates the subsidiary as debtor-in-possession.

In some cases, an entity that has filed for bankruptcy may be consolidated with other entities (subsidiaries) that are not included in the reorganization proceedings. In such cases, the consolidated financial statements should include separate condensed combined financial statements (prepared on the same basis as the consolidated statements) of only the entities included in the reorganization proceedings. Intercompany receivables and payables of entities in reorganization proceedings should be disclosed in the condensed combined financial statements.

In addition, when a parent company loses control of a bankrupt subsidiary, the subsidiary in bankruptcy should evaluate intercompany payables and receivables the same as claims with an unaffiliated third party. In other words, liabilities should be recorded at the expected amount of the allowed claim (see Section 3.1.1) and receivables should be evaluated in accordance with ASC 310, *Receivables – Overall.*

3.5. Required disclosures

Entities that are in the midst of a reorganization proceeding are required to provide the following additional disclosures:

- Claims not subject to reasonable estimation (based on the provisions of ASC 450-20, *Contingencies – Loss Contingencies*)
- The principal categories of the claims subject to compromise
- The extent to which reported interest expense differs from stated contractual interest
- Inter-company receivables and payables of entities in reorganization proceedings (if the entity is required to present condensed combined financial statements)
- Details of operating cash receipts and payments resulting from the reorganization (if the statement of cash flows is prepared using the indirect method)

Additionally, ASC 852-10-45-16 notes that when earnings per share are required to be reported, additional disclosure should be made if it is probable that the plan will require the issuance of additional common stock or common stock equivalents.

Refer to Section 4 of Appendix A for sample disclosures.

4. Financial reporting for the final period immediately preceding the date the plan has been confirmed

The financial statements of the entity as of and for the period immediately preceding the date of Court confirmation of the plan should include all activity through that date in accordance with the guidance in Section 3. Additionally, the effects of the adjustments on the reported amounts of individual assets and liabilities resulting from the adoption of fresh-start accounting (described in Section 5.1) should be disclosed in those financial statements as a subsequent event. This also includes the effects of any forgiveness of debt.

5. Financial reporting upon emergence from bankruptcy

Upon emergence from bankruptcy, the entity emerging must, at a minimum, record the effects of its reorganization plan. If the entity qualifies for *fresh-start* reporting, which is typically the case, the financial statements are adjusted to report the fair value of the assets and liabilities upon emergence. The following section walks through the qualifications for and application of fresh-start accounting.

5.1. Fresh-start accounting

Fresh-start accounting essentially allows an entity to reset and present financial statements as a new entity formed upon emergence from bankruptcy. As a result, when discussing an entity applying fresh-start accounting, the terms *predecessor* and *successor* are used to distinguish between the preexisting entity that filed for bankruptcy (predecessor) and the new entity that results from the application of fresh-start accounting (successor).

5.1.1. Qualifying for fresh-start accounting

To qualify for fresh-start reporting, ASC 852-10-45-19 requires the following criteria be met:

- The reorganization value of the assets of the emerging entity immediately before the date of confirmation is less than the total of all postpetition liabilities and allowed claims, and
- Holders of existing voting shares immediately before confirmation receive less than 50% of the voting shares of the emerging entity

To meet the first criterion, the entity must compare the reorganization value of the assets to the total of all postpetition liabilities and allowed claims. While the Court determines the adequacy of the disclosure statement, entities that expect to adopt fresh-start accounting should report information about the reorganization value in the disclosure statement. This will allow creditors and stockholders to determine whether the first criterion is met and can make an informed judgment about the plan. The most likely place to report the reorganization value is in the pro forma balance sheet that is commonly part of the disclosure statement. Because reorganization value may not have been allocated to individual assets concurrently with the preparation of the pro forma balance sheet included in the disclosure statement in some cases, it may be necessary to include in the pro forma balance sheet a separate line item to reflect the excess of the total reorganization value of the emerging entity over recorded amounts. When possible, reorganization value should be segregated into major categories. Refer to Section 2.2 for additional information on reorganization value.

To meet the second criterion, the loss of control contemplated by the plan must be substantive and not temporary. In other words, the controlling interest cannot revert to the shareholders existing immediately before the plan was filed or confirmed.

5.1.2. Applying fresh-start accounting

Once an entity has determined that it qualifies for fresh-start accounting, it must determine the date when fresh-start reporting should be applied. ASC 852-10-45-17 specifies that fresh-start accounting should be applied at the emergence date, which is later of the following two dates:

- The date that the Court has confirmed its reorganization plan
- The date that all material, unresolved conditions precedent to the plan's becoming binding are resolved

In some cases, for the sake of convenience, entities will choose a period-end date near the confirmation date to use as the date for applying fresh-start accounting. However, this is only permissible if it does not have a material effect on the financial statements and no material transactions have occurred between the emergence date and the convenience date. Furthermore, the fresh-start adjustments cannot be reported in a reporting period prior to the actual emergence date. For example, if the Court unconditionally confirms a reorganization plan for a calendar year-end entity on January 2, 20X2, it would not be permissible for the entity to apply fresh-start accounting in its December 31, 20X1 statements. Instead, the fresh-start adjustments would be recorded during the two-day period ended January 2, 20X2, the final day of the predecessor's operating results. Conversely, if the Court confirms the reorganization plan on December 27, 20X1, the entity could choose to include the activity from December 27 through December 31 in its predecessor financial statements, if the activity were immaterial. That said, the entity would still be required to date the predecessor statements for the period ended December 27, as that is the actual date of emergence. The successor statements could then be presented using the predecessor's ending balances from December 27 as the beginning balances on January 1, 20X2, because the immaterial activity between December 27 and 31 would be included in the December 27 predecessor balances.

Entities that qualify for fresh-start accounting should apply the guidance in ASC 805, *Business Combinations*, to assign the reorganization value to the assets and liabilities. This generally requires that all assets and liabilities be recorded at their fair values, including any identifiable intangible assets that had not been previously recorded. Any portion of reorganization value that cannot be attributed to a specific tangible or an identified intangible asset should be reported as goodwill in accordance with ASC 350, *Intangibles—Goodwill and Other*. For additional information on how to assign values to the assets and liabilities and calculate goodwill, refer to our guide, a guide to accounting for business combinations (fourth edition).

The business combinations guidance in ASC 805 provides for a measurement period of one year after the closing date to allow management to obtain additional facts needed to appropriately measure assets and liabilities as of the date the business combination occurred. While the reorganization guidance in ASC 852 does refer to the guidance in ASC 805 for assigning the reorganization values of the assets and liabilities, it does not incorporate the concept of a "measurement period." Rather, because the values of assets and liabilities are determined during the reorganization period, which ends with the confirmation of the plan of reorganization, all assets and liabilities should be recorded at their fair values upon the application of fresh-start accounting.

The effect of the reorganization and the adoption of fresh-start accounting are generally displayed in the footnotes using the following four columns:

- *Predecessor.* This column should reflect the final balances of the predecessor entity just prior to confirmation of the plan. It does not include any adjustments for reorganization or fresh-start accounting. For example, the full allowed claim amounts for liabilities subject to compromise should be included in this column.
- *Reorganization adjustments.* This column should show only the effects of the reorganization plan. For example, this will typically include the write off of debt forgiven under the reorganization plan, the issuance of new successor stock (to satisfy lender claims) and any gain on the settlement of liabilities subject to compromise.

- *Fresh-start adjustments*. This column reflects the application of ASC 805 and includes any adjustments made to assets and liabilities to bring them to their fair values, the recognition of goodwill and an adjustment to reset retained earnings to zero.
- *Successor.* This column reflects the closing balances of the predecessor company and opening balances of the successor entity after the adoption of fresh-start accounting. The total assets reported in this column should equal the reorganization value and the total equity should equal the enterprise value.

Example: Fresh-start accounting disclosure

The following illustrates a typical financial statement disclosure showing the effect of reorganization and fresh-start accounting.

	Predecessor	Reorganization adjustments	Fresh-start adjustments	Successor
Assets				
Cash	$ XXX	-	-	$ XXX
Trade accounts receivable, net	XXX	-	-	XXX
Inventories, net	XXX	-	-	XXX
Prepaid expenses	XXX	-	-	XXX
Other current assets	XXX	-	-	XXX
Total current assets	XXX	-	-	XXX
Property, plant and equipment, net	XXX	-	XXX (d)	XXX
Intangible assets, net	XXX	-	XXX (d)	XXX
Goodwill	-	-	XXX (e)	XXX
Total assets	XXX	-	XXX	XXX
Liabilities and Stockholders' Equity (Deficit)				
Current liabilities				
Accounts payable	$ XXX	-	-	$ XXX
Accrued expenses	XXX	-	-	XXX
Deferred revenue	XXX	-	-	XXX
Total current liabilities	XXX	-	-	XXX
Debtor-in-possession financing	XXX	-	-	XXX
Liabilities subject to compromise	XXX	XXX (a)	-	-
Total liabilities	XXX	XXX	-	XXX
Predecessor common stock	XXX	-	(XXX) (f)	-
Predecessor additional paid-in capital	XXX	-	(XXX) (f)	-
Successor common stock	-	XXX (b)	-	XXX
Successor additional paid-in-capital	-	XXX (b)	-	XXX
Retained earnings (accumulated deficit)	(XXX)	XXX (c)	XXX (g)	-
Total stockholders' equity	(XXX)	XXX	XXX	XXX
Total liabilities and stockholders' equity	XXX	-	XXX	XXX

(a) Elimination of the liabilities subject to compromise under the Reorganization Plan.
(b) Issuance of common stock to existing creditors for the cancelation of indebtedness.
(c) Cumulative impact of reorganization adjustments described in (a) and (b).
(d) Fresh-start adjustments to property, plant and equipment and intangible assets to reflect their fair values (assumes for simplicity the carrying amounts of other items approximate fair value).
(e) Fresh-start adjustment to reflect the recognition of goodwill.
(f) Cancellation of the predecessor's common stock. While ASC 852-10-55-10 presents the adjustments to predecessor common stock and APIC in a separate column, there is diversity in practice on whether this is presented as a reorganization adjustment or a fresh-start reporting adjustment.
(g) Resetting retained earnings or accumulated deficit to zero.

When applying fresh-start accounting, deferred taxes should continue to be reported in conformity with other applicable U.S. GAAP. If not recognizable at the plan confirmation date, initial recognition (that is, by elimination of the valuation allowance) of tax benefits realized from preconfirmation net operating loss carryforwards and deductible temporary differences should be reported as a reduction to income tax expense.

An emerging entity should follow only the U.S. GAAP in effect at the date fresh-start accounting is adopted, which includes the guidance eligible for early adoption if an election is made to adopt it early.

5.1.3. Required disclosures

Fresh-start accounting results in a new reporting entity with no beginning retained earnings or deficit. When fresh-start accounting is permitted to be adopted, ASC 852-10-50-7 requires that the following information be disclosed in the notes to the initial financial statements of the emerged entity:

a. Adjustments to the historical amounts of individual assets and liabilities

b. The amount of debt forgiveness

c. Significant matters relating to the determination of reorganization value, including all of the following:

    1. The method or methods used to determine reorganization value and factors such as discount rates, tax rates, the number of years for which cash flows are projected, and the method of determining terminal value

    2. Sensitive assumptions — that is, assumptions about which there is a reasonable possibility of the occurrence of a variation that would have significantly affected measurement of reorganization value

    3. Assumptions about anticipated conditions that are expected to be different from current conditions, unless otherwise apparent.

Fresh-start financial statements are not comparable with those prepared before emergence from Chapter 11 because they are, in effect, those of a new entity. Therefore, comparative financial statements that straddle a confirmation date should not be presented. The SEC and other regulatory agencies may, however, require the presentation of the predecessor financial statements. When the predecessor entity's financial statements are presented, they should be clearly distinguished from those of the emerged entity. This is typically achieved by separating the predecessor numbers from the successor numbers with a vertical dark black line.

5.2. Emerging entities not qualifying for fresh-start accounting

Entities emerging from Chapter 11 that do not qualify for fresh-start accounting, record the effects of the bankruptcy in the financial statements, but do not present separate predecessor and successor financial statements. Instead, they should report liabilities compromised by confirmed plans based on the present value of amounts to be paid determined at appropriate current interest rates for similar debt having similar credit characteristics. Any gain resulting from liabilities being compromised is reported as a reorganization item. No adjustments are made to assets or uncompromised liabilities, and retained earnings is not reset to zero. See Appendix C for illustrative financial statements for an entity emerging from Chapter 11 without qualifying for fresh-start accounting.

Appendix A: Illustrative statements for entity operating under Chapter 11

Example 1 in ASC 852-10-55-3 provides the following sample statements for XYZ Company, a manufacturing concern headquartered in Tennessee, with a fiscal year ending on December 31. In this example, the entity is operating under Chapter 11 as the debtor-in-possession. Although the FASB's example only presents a single year to highlight the impact of operating under Chapter 11, while an entity is operating under Chapter 11 prior to emergence from bankruptcy and the application of fresh-start accounting, comparative financial statements should be considered and are often presented.

A.1. Balance sheet

XYZ Company
(Debtor-in-Possession)
Balance Sheet
December 31, 19X1

Assets		**(000s)**	
Current assets			
Cash	$	110	
Accounts receivable, net		300	
Inventory		250	
Other current assets		30	
Total current assets		690	
Property, plant and equipment, net		430	
Goodwill		210	
Total Assets	$	1,330	
Liabilities and Stockholders' Deficit		**(000s)**	
Liabilities Not Subject to Compromise Current Liabilities:			
Short-term borrowings	$	25	
Accounts payable – trade		200	
Other liabilities		50	
Total current liabilities		275	
Liabilities Subject to Compromise		1,100	(a)
Total liabilities		1,375	
Stockholders' (deficit)			
Preferred stock		325	
Common stock		75	
Retained earnings (deficit)		(445)	
		(45)	
	$	1,330	

(a) Liabilities subject to compromise consist of the following:

Secured debt, 14%, secured by first mortgage on building	$	300,000	(b)
Priority tax claims		50,000	
Senior subordinated secured notes, 15%		275,000	
Trade and other miscellaneous claims		225,000	
Subordinated debentures, 17%		250,000	
	$	1,100,000	

(b) The secured debt in this case should be considered, due to various factors, subject to compromise.

The accompanying notes are an integral part of the financial statements.

A.2. Income statement

XYZ Company
(Debtor-in-Possession)
Statement of Operations
For the Year Ended December 31, 19X1
(000s)

		19X1
Revenues:		
Sales	$	2,400
Cost and expenses:		
Cost of goods sold		1,800
Selling, operating and administrative		550
Interest (contractual interest $5)		3
		2,353
Earnings before reorganization items and income tax benefit		47
Reorganization items:		
Loss on disposal of facility		(60)
Professional fees		(50)
Provision for rejected executory contracts		(10)
Interest earned on accumulated cash resulting from Chapter 11 proceeding		1
		(119)
Loss before income tax benefit and discontinued operations		(72)
Income tax benefit		10
Loss before discontinued operations		(62)
Discontinued operations:		
Loss from operations of discontinued products segment		(56)
Net loss	$	(118)
Loss per common share:		
Loss before discontinued operations	$	(0.62)
Discontinued operations	$	(0.56)
Net loss	$	(1.18)

The accompanying notes are an integral part of the financial statements.

A.3. Statement of cash flows

XYZ Company
(Debtor-in-Possession)
Statement of Cash Flows
For the Year Ended December 31, 19X1
(000s)

		19X1
Cash flows from operating activities:		
Cash received from customers	$	2,220
Cash paid to suppliers and employees		(2,070)
Interest paid		(3)
Net cash provided by operating activities before reorganization items		147
Operating cash flows from reorganization items:		
Interest received on cash accumulated because of the Chapter 11 proceeding		1
Professional fees paid for services rendered in connection with the Chapter 11 proceeding		(50)
Net cash used by reorganization items		(49)
Net cash provided by operating activities		98
Cash flows from investing activities:		
Capital expenditures		(5)
Proceeds from sale of facility due to Chapter 11 proceeding		40
Net cash provided by investing activities		35
Cash flow used by financing activities:		
Net borrowings under short-term credit facility (post petition)		25
Repayment of cash overdraft		(45)
Principal payments on prepetition debt authorized by court		(3)
Net cash provided by financing activities		(23)
Net increase in cash and cash equivalents		110
Cash and cash equivalents at beginning of year		-
Cash and cash equivalents at end of year	$	110
Reconciliation of net loss to net cash provided by operating activities		
Net loss	$	(118)
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation		20
Loss on disposal of facility		60
Provision for rejected executory contracts		10
Loss on discontinued operations		56

		19X1
Increase in postpetition payables and other liabilities		250
Increase in accounts receivable		(180)
Net cash provided by operating activities	$	98

The accompanying notes are an integral part of the financial statements.

A.4. Disclosures

Example 1 in ASC 852-10-55-3 provides the following sample disclosure note for XYZ Company, a manufacturing entity headquartered in Tennessee that has filed a petition for relief under Chapter 11:

Note X. Petition for Relief Under Chapter 11

On January 10, 19X1, XYZ Company (the Debtor) filed petitions for relief under Chapter 11 of the federal bankruptcy laws in the United States Bankruptcy Court for the Western District of Tennessee. Under Chapter 11, certain claims against the Debtor in existence before the filing of the petitions for relief under the federal bankruptcy laws are stayed while the Debtor continues business operations as Debtor-in-possession. These claims are reflected in the December 31, 19X1, balance sheet as liabilities subject to compromise. Additional claims (liabilities subject to compromise) may arise after the filing date resulting from rejection of executory contracts, including leases, and from the determination by the court (or agreed to by parties in interest) of allowed claims for contingencies and other disputed amounts. Claims secured against the Debtor's assets (secured claims) also are stayed, although the holders of such claims have the right to move the court for relief from the stay. Secured claims are secured primarily by liens on the Debtor's property, plant, and equipment.

The Debtor received approval from the Bankruptcy Court to pay or otherwise honor certain of its prepetition obligations, including employee wages and product warranties. The Debtor has determined that there is insufficient collateral to cover the interest portion of scheduled payments on its prepetition debt obligations. Contractual interest on those obligations amounts to $5,000, which is $2,000 in excess of reported interest expense; therefore, the debtor has discontinued accruing interest on these obligations. See Note X in Example 2 (paragraph 852-10-55-11) for a discussion of the credit arrangements entered into after the Chapter 11 filings.

Appendix B: Fresh-start accounting and illustrative notes to financial statements

ASC 852-10-55-4 to 55-11 includes an example to illustrate the fresh-start related guidance. The guidance is applied to XYZ Company, a manufacturing concern headquartered in Tennessee, with a fiscal year ending on December 31. On January 10, 19X1, XYZ filed a petition for relief under Chapter 11. ASC 852-10-55-5 to 55-11 are reproduced below.

> The Bankruptcy Court confirmed XYZ's plan of reorganization as of June 30, 19X2. It was determined that XYZ's reorganization value computed immediately before June 30, 19X2, the date of plan confirmation, was $1,300,000, which consisted of the following.

Cash in excess of normal operating requirements generated by operations	$ 150,000
Net realizable value of asset dispositions	75,000
Present value of discounted cash flows of the emerging entity	1,075,000
Reorganization value	$ 1,300,000

> XYZ Company adopted fresh-start reporting because holders of existing voting shares immediately before filing and confirmation of the plan received less than 50% of the voting shares of the emerging entity and its reorganization value is less than its postpetition liabilities and allowed claims as shown in the following table

Postpetition current liabilities	$ 300,000
Liabilities deferred pursuant to Chapter 11 proceeding	1,100,000
Total postpetition liabilities and allowed claims	1,400,000
Reorganization value	(1,300,000)
Excess of liabilities over reorganization value	$ 100,000

> The reorganization value of the XYZ Company was determined in consideration of several factors and by reliance on various valuation methods, including discounting cash flow and price/earnings and other applicable ratios. The factors considered by XYZ Company included all of the following:

a. Forecasted operating and cash flow results that gave effect to the estimated impact of both of the following:
    1. Corporate restructuring and other operating program changes
    2. Limitations on the use of available net operating loss carryovers and other tax attributes resulting from the plan of reorganization and other events.
b. The discounted residual value at the end of the forecast period based on the capitalized cash flows for the last year of that period
c. Market share and position
d. Competition and general economic considerations
e. Projected sales growth
f. Potential profitability
g. Seasonality and working capital requirements.

> After consideration of XYZ Company's debt capacity and other capital structure considerations, such as industry norms, projected earnings to fixed charges, earnings before interest and taxes to interest, free cash flow to interest, and free cash flow to debt service and other applicable ratios, and after extensive negotiations among parties in interest, it was agreed that XYZ's reorganization capital structure should be as follows.

Postpetition current liabilities	$ 300,000
Internal Revenue Service (IRS) note	50,000
Senior debt	275,000 (a)
Subordinated debt	175,000

Common stock	350,000
Reorganization capital structure	$ 1,150,000 (b)

(a) Due $50,000 per year for each of the next 4 years, at 12% interest, with $75,000 due in the fifth year.

(b) See the table in paragraph 852-10-55-10 for the balance sheet adjustments required to reflect XYZ Company’s reorganization value as of the date of plan confirmation.

The following entries record the provisions of the plan and the adoption of fresh-start reporting.

Entries to record debt discharge:

Liabilities subject to compromise	$ 1,100,000	
Senior debt–current		$ 50,000
Senior debt–long-term		225,000
IRS note		50,000
Cash		150,000
Subordinated debt		175,000
Common stock (new)		86,000
Additional paid-in capital		215,000
Gain on debt discharge		149,000

Entries to record exchange of stock for stock:

Preferred stock	325,000	
Common stock (old)	75,000	
Common stock (new)		14,000
Additional paid-in capital		386,000

Entries to record the adoption of fresh-start reporting and to eliminate the deficit:

Inventory	50,000	
Property, plant and equipment	175,000	
Reorganization value in excess of amounts allocable to identifiable assets	175,000	
Gain on debt discharge	149,000	
Additional paid-in capital	351,000	
Goodwill		200,000
Deficit		700,000

The effect of the plan of reorganization on XYZ Company's balance sheet, as of June 30, 19X2, is as follows.

		Adjustment to Record Confirmation of Plan			
Assets	**Pre-confirmation**	**Debt discharge**	**Exchange of stock**	**Fresh start**	**XYZ Company's Reorganized Balance Sheet**
Current Assets:					
Cash	$ 200,000	$ (150,000)			$ 50,000
Receivables	250,000				250,000
Inventory	175,000			$ 50,000	225,000
Assets held for sale	25,000				25,000
Other current assets	25,000				25,000
	675,000	(150,000)		50,000	575,000
Property, plant, and equipment	175,000			175,000	350,000
Assets held for sale	50,000				50,000
Goodwill	200,000			(200,000)	
Reorganization value in excess of amounts allocable to identifiable assets				175,000	175,000
	$ 1,100,000	$ (150,000)		$ 200,000	$ 1,150,000
Liabilities and Shareholders' Deficit					
Liabilities Not Subject to Compromise					
Current liabilities					
Short-term borrowings	$ 25,000				$ 25,000
Current maturities of senior debt		$ 50,000			50,000
Accounts payable trade	175,000				175,000
Other liabilities	100,000				100,000
	300,000	50,000			350,000
Liabilities Subject to Compromise					
Prepetition liabilities	1,100,000	(1,100,000)			
IRS note		50,000			50,000
Senior debt, less current maturities		225,000			225,000
Subordinated debt		175,000			175,000
Shareholders' Deficit:					
Preferred stock	325,000		$ (325,000)		
Additional paid-in capital		215,000	386,000	$ (351,000)	250,000
Common stock—old	75,000		(75,000)		
Common stock—new		86,000	14,000		100,000
Retained earnings (deficit)	(700,000)	149,000		700,000	
				(149,000)	
	(300,000)	450,000		200,000	350,000
	$ 1,100,000	$ (150,000)	$ -	$ 200,000	$ 1,150,000

The following illustrative disclosure discusses the details of XYZ Company's confirmed plan of reorganization. In this illustration a tabular presentation entitled Plan of Reorganization Recovery Analysis is incorporated in the note disclosure. The plan of reorganization recovery analysis may alternatively be presented as supplementary information to the financial statements.

Note X - Plan of Reorganization

On June 30, 19X2, the Bankruptcy Court confirmed the Company's plan of reorganization. The Company accounted for the reorganization using fresh-start reporting. Accordingly, all assets and liabilities are adjusted to fair value in accordance with accounting requirements for business combinations under ASC Topic 805. The excess of reorganization value over the fair value of tangible and intangible assets was recorded as "reorganization value in excess of amounts allocable to identifiable assets." The confirmed plan provided for the following:

- Secured Debt—The Company's $300,000 of secured debt (secured by a first mortgage lien on a building located in Nashville, Tennessee) was exchanged for $150,000 in cash and a $150,000 secured note, payable in annual installments of $27,300 commencing on June 1, 19X3, through June 1, 19X6, with interest at 12% per annum, with the balance due on June 1, 19X7.
- Priority Tax Claims—Payroll and withholding taxes of $50,000 are payable in equal annual installments commencing on July 1, 19X3, through July 1, 19X8, with interest at 11% per annum.
- Senior Debt—The holders of approximately $275,000 of senior subordinated secured notes received the following instruments in exchange for their notes: $87,000 in new senior secured debt, payable in annual installments of $15,800 commencing March 1, 19X3, through March 1, 19X6, with interest at 12% per annum, secured by first liens on certain property, plants, and equipment, with the balance due on March 1, 19X7; $123,000 of subordinated debt with interest at 14% per annum due in equal annual installments commencing on October 1, 19X3, through October 1, 19X9, secured by second liens on certain property, plant, and equipment; and 11.4% of the new issue of outstanding voting common stock of the Company.
- Trade and Other Miscellaneous Claims—The holders of approximately $225,000 of trade and other miscellaneous claims received the following for their claims: $38,000 in senior secured debt, payable in annual installments of $6,900 commencing March 1, 19X3, through March 1, 19X6, with interest at 12% per annum, secured by first liens on certain property, plants, and equipment, with the balance due on March 1, 19X7; $52,000 of subordinated debt, payable in equal annual installments commencing October 1, 19X3, through October 1, 19X8, with interest at 14% per annum; and 25.7% of the new issue of outstanding voting common stock of the Company.
- Subordinated Debentures—The holders of approximately $250,000 of subordinated unsecured debt received, in exchange for the debentures, 48.9% of the new issue outstanding voting common stock of the Company.
- Preferred Stock—The holders of 3,250 shares of preferred stock received 12% of the outstanding voting common stock of the new issue of the Company in exchange for their preferred stock.
- Common Stock—The holders of approximately 75,000 outstanding shares of the Company's existing common stock received, in exchange for their shares, 2% of the new outstanding voting common stock of the Company.

The following table (Plan of Reorganization Recovery Analysis) summarizes the adjustments required to record the reorganization and the issuance of the various securities in connection with the implementation of the plan.

		Recovery									
								Common Stock (a)		Total Recovery	
		Elimination of Debt and Equity	Surviving Debt	Cash	IRS Note	Senior Debt	Subordinated Debt	%	Value	$	%
Postpetition liabilities	$ 300,000		$ 300,000							$ 300,000	100%
Claim or interest											
Secured debt	300,000			$ 150,000		$ 150,000				300,000	100
Priority tax claim	50,000				$ 50,000					50,000	100
Senior debt	275,000	$ (25,000)				87,000	$123,000	11.4%	$ 40,000	250,000	91
Trade and other miscellaneous claims	225,000	(45,000)				38,000	52,000	25.7	90,000	180,000	80
Subordinated debentures	250,000	(79,000)						48.9	171,000	171,000	68
	1,100,000										
Preferred stockholders	325,000	(283,000)						12.0	42,000	42,000	
Common stockholders	75,000	(68,000)						2.0	7,000	7,000	
Deficit	(700,000)	700,000									
Total	$ 1,100,000	$ 200,000	$ 300,000	$ 150,000	$ 50,000	$ 275,000	$ 175,000	100.0%	$ 350,000	$ 1,300,000	

(a) The aggregate par value of the common stock issued under the plan is $100,000.

Appendix C: Illustrative statements for entity emerged from Chapter 11 that does not qualify for fresh-start accounting

In this sample, the entity has emerged from Chapter 11 during the most recent year and does not qualify for fresh-start accounting.

C.1. Balance sheet

Try Again Company
Balance Sheets
December 31, 20X2 and 20X1

Assets	**20X2**	**20X1**
Current assets:		
Cash and cash equivalents	$ XXX	$ XXX
Accounts receivable, less allowance for doubtful accounts for 20X2 of $XXX and for 20X1 of $XXX	XXX	XXX
Inventories	XXX	XXX
Other current assets	XXX	XXX
Total current assets	XXX	XXX
Property and equipment, less accumulated depreciation for 20X2 of $XXX and for 20X1 of $XXX	XXX	XXX
Other assets	XXX	XXX
	$ XXX	$ XXX
Liabilities and Stockholders' Equity (Deficit)		
Current liabilities		
Notes payable	$ XXX	$ XXX
Current maturities of long-term debt	XXX	-
Accounts payable	XXX	XXX
Other current liabilities	XXX	XXX
Total current liabilities	XXX	XXX
Long-term debt, less current maturities	XXX	-
Liabilities subject to compromise	-	XXX
Total liabilities	XXX	XXX
Stockholders' equity (deficit)		
Preferred stock, XX% noncumulative, $XXX par value; authorized XXX shares; issued and outstanding XXX shares	XXX	XXX
Common stock, $XXX par value; authorized XXX shares; issued and outstanding XXX shares	XXX	XXX
Additional paid-in capital	(XXX)	(XXX)
Retained earnings (deficit)	(XXX)	(XXX)
Total stockholders' equity	XXX	XXX
	$ XXX	$ XXX

C.2. Income statement

Try Again Company
Statement of Income
Years Ended December 31, 20X2 and 20X1

	20X2		20X1	
Sales	$	XXX	$	XXX
Other operating revenue, primarily commissions		XXX		XXX
		XXX		XXX
Costs and expenses:				
Cost of goods sold		XXX		XXX
Selling, general and administrative		XXX		XXX
Interest (contractual interest 20X2 $XXX; 20X1 $XXX)		XXX		XXX
		XXX		XXX
Income before reorganization items		XXX		XXX
Reorganization items:				
Gain on restructuring of debt				XXX
(Loss) on disposal of facility		-		(XXX)
Professional fees		(XXX)		(XXX)
Provision for rejected executory contracts		-		(XXX)
Interest earned on accumulated cash resulting from Chapter 11 proceeding		XXX		XXX
		(XXX)		(XXX)
Net income (loss)	$	XXX	$	(XXX)

C.3. Statement of cash flows

Try Again Company
Statement of Cash Flows
Years Ended December 31, 20X2 and 20X1

	20X2		20X1	
Cash flows from operating activities				
Cash received from customers	$	XXX	$	XXX
Cash paid to suppliers and employees		(XXX)		(XXX)
Interest paid		(XXX)		(XXX)
Net cash provided by operating activities before reorganization items		XXX		XXX

	20X2	20X1
Operating cash flows from reorganization items:		
Interest received on cash accumulated because of the Chapter 11 proceeding	XXX	XXX
Professional fees paid for services in connection with the Chapter 11 proceeding	(XXX)	(XXX)
Net cash (used in) reorganization items	(XXX)	(XXX)
Net cash provided by operating activities	XXX	XXX
Cash flows from investing activities		
Purchase of property and equipment	(XXX)	(XXX)
Proceeds from sale of facility due to Chapter 11 proceeding	-	XXX
Net cash provided by (used in) investing activities	(XXX)	XXX
Cash flows from financing activities		
Net borrowings under postpetition short-term credit facility	XXX	XXX
Repayment of cash overdraft	-	(XXX)
Repayment of long-term debt	(XXX)	-
Principal payments on prepetition debt authorized by Bankruptcy Court	(XXX)	(XXX)
Net cash (used in) financing activities	(XXX)	(XXX)
Net increase (decrease) in cash and cash equivalents	(XXX)	XXX
Cash and cash equivalents:		
Beginning	XXX	XXX
Ending	$ XXX	$ XXX
Reconciliation of net income (loss) to net cash provided by operating activities		
Net income (loss)	$ XXX	$ (XXX)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	XXX	XXX
Gain on restructuring of debt	(XXX)	-
Loss on disposal of facility	-	XXX
Provision for rejected executory contracts	-	XXX
Change in working capital components (increase) decrease in:		
Accounts receivable	(XXX)	(XXX)
Inventories	(XXX)	XXX
Increase (decrease) in:		
Accounts payable	XXX	XXX

	20X2	20X1
Other current liabilities	(XXX)	(XXX)
Net cash provided by operating activities	$ XXX	$ XXX

Supplemental schedule of noncash investing and financing activities:	
Issuance of long-term debt in settlement of certain liabilities subject to compromise	$ XXX
Issuance of preferred stock in settlement of certain liabilities subject to compromise	$ XXX

C.4. Disclosures

The following illustrative footnote disclosure discusses the details of Try Again Company's confirmed plan of reorganization in the year it emerges from bankruptcy proceedings but does not qualify for fresh-start accounting.

Note X. Plan of reorganization

On June 30, 20X2, the Bankruptcy Court confirmed the Company's plan of reorganization, which was approved by the Company's creditors on August 7, 20X2. The confirmed plan provided for the following:

- Secured debt: The Company's $XXX of secured debt (secured by a first mortgage lien on a building) was exchanged for $XXX in cash and a $XXX senior secured note, payable in annual installments of $ XXX commencing on June 1, 20X3, through June 1, 20X6, with interest at 12% per annum, with the balance due on June 1, 20X7.
- Senior debt: The holders of approximately $XXX of senior subordinated secured notes received the following instruments in exchange for their notes: (a) $XXX in new senior secured debt, payable in annual installments of $XXX commencing on March 1, 20X3, through March 1, 20X6, with interest at 12% per annum, secured by first liens on certain property and equipment, with the balance due March 1, 20X7; (b) $XXX of subordinated debt with interest at 14% per annum due in equal annual installments commencing on October 1, 20X3, through October 1, 20X9, secured by second liens on certain property and equipment; and (c) 15.3% of the Company's preferred stock.
- Trade and other miscellaneous claims: The holders of approximately $XXX of trade and other miscellaneous claims received the following for their claims: (a) $XXX in senior secured debt, payable in annual installments of $XXX commencing March 1, 20X3, through March 1, 20X6, with interest at 12% per annum, secured by first liens on certain property and equipment, with the balance due on March 1, 20X7; (b) $XXX of subordinated debt with interest at 14% per annum due in equal annual installments commencing on October 1, 20X3, through October 1, 20X9; and (c) 31.5% of the Company's common stock.

As a result of the reorganization, the Company recognized a gain of $XXX on the restructuring of debt. There was no tax effect attributable to this gain.

Upon the final approval of the Company's plan of reorganization, the Company ceased operating as a debtor-in-possession.

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