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EXPOSURE DRAFT

PROPOSED STATEMENT OF POSITION

FINANCIAL REPORTING BY ENTITIES IN REORGANIZATION UNDER THE BANKRUPTCY CODE

April 4, 1990

Prepared by the Task Force on Financial Reporting by Entities in Reorganization Under the Bankruptcy Code, Accounting Standards Division, American Institute of Certified Public Accountants

Comments should be received by July 2, 1990, and addressed to:
Albert Goll, Technical Manager, Accounting Standards Division, File 2215,
AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775

G00580

SUMMARY

This proposed statement of position provides guidance for financial reporting by entities that have filed petitions with the Bankruptcy Court and expect to reorganize as going concerns under Chapter 11 of title 11 of the United States Code.

It recommends that all such entities report the same way while reorganizing under Chapter 11, with the objective of reflecting their financial evolution. To do that, their financial statements should distinguish transactions and events that are directly associated with the reorganization from the operations of the ongoing business as it evolves.

The statement recommends that, on emergence from Chapter 11, entities meeting specified criteria adopt fresh start reporting since, in substance, the creditors have acquired the entities. It also recommends how entities not meeting those criteria should report their liabilities.

This exposure draft has been sent to--

- *State society and chapter presidents, directors, and committee chairmen*
- *Association of Insolvency Accountants*
- *Persons who have requested copies*

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April 4, 1990

An exposure draft of a proposed AICPA statement of position (SOP), Financial Reporting by Entities in Reorganization Under the Bankruptcy Code, accompanies this letter. A summary of the proposed SOP is also enclosed.

The proposed SOP was developed to promote uniform, realistic financial reporting for entities during reorganization under Chapter 11 of the Bankruptcy Code and upon emergence from such reorganization. No guidance specifically on those topics is available in the financial reporting literature.

For that purpose, the Accounting Standards Executive Committee established a task force with widely diversified experience. The results of its efforts are enclosed for your review and comment.

Supplementary Issue

The third bullet under Paragraph 38 of the exposure draft recommends that subsequent benefits from net operating loss carryforwards should first reduce "reorganization value in excess of amounts allocable to identifiable assets" and other intangibles until exhausted and thereafter be reported as reductions of income tax expense.

AcSEC and a minority of the task force support that view because they believe it accords with the model of a purchase business combination used to allocate the reorganization value of the emerging entity. Under that view, paragraph 23 of FASB Statement No. 96, Accounting for Income Taxes, applies. It requires that operating loss or tax credit carryforwards that are recognized in financial statements after the acquisition date first be applied to reduce to zero any goodwill and other noncurrent intangible asset related to acquisition and next be recognized as a reduction in income tax expense.

The FASB, the SEC staff, and a majority of the task force agree with the proposal that subsequent realizations of net operating loss (NOL) carryforwards should first reduce intangibles but believe that any excess should be reported as a direct addition to contributed capital.

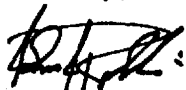
Their view is that recognizing the benefit of pre-NOL carryforwards in the income statement of the "new" entity is not consistent with the notion of a fresh start. The practical effect of this is to apply NOL carryforwards realized first against excess reorganization value and then directly to contributed capital. That treatment would be similar to the requirements under APB 11 paragraph 50 and Statement No. 96 (paragraph 54) for quasi-reorganizations.

Commentators are asked to state their preference as to the reporting for NOLs realized after fresh start reporting begins.

Responses should be sent to Al Goll, Technical Manager, Accounting Standards Division, AICPA, 1211 Avenue of the Americas, New York, NY, 10036-8775, File No. 2215, to be received as soon as possible but no later than July 2, 1990.

Written comments on the exposure draft will become part of the public record of the AICPA for one year after July 31, 1990.

Sincerely,



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In addition to the chairman, John Robbins of Kenneth Leventhal & Company, Warren Petraglia and Alan Jacobs of Ernst & Young and Peter Gibbons of Price Waterhouse specialize in reorganizations. Grant Newton is professor of accounting at Pepperdine University and author of a book on bankruptcy and insolvency accounting practice and procedures. Ron Orr specializes in bankruptcy proceedings with the law firm of Gibson, Dunn & Crutcher, Keith Rowden is on the FASB staff, and Clarence Staubs was on the SEC staff until his retirement. George Patterson of Kenneth Leventhal & Company did most of the drafting.

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FINANCIAL REPORTING BY ENTITIES IN REORGANIZATION UNDER THE BANKRUPTCY CODE

INTRODUCTION

1. This statement of position was prepared by the Task Force on Financial Reporting by Entities in Reorganization Under the **Bankruptcy Code** to provide guidance on financial reporting by entities that have filed petitions with the **Bankruptcy Court** and expect to reorganize as going concerns under Chapter 11 of title 11 of the United States Code (**Chapter 11**).[1]

Petition, Proceeding, and Plan

2. An entity enters reorganization under Chapter 11 by filing a **petition** with the Bankruptcy Court, an adjunct of the United States District Courts. The filing of the petition starts the **reorganization proceeding**. The goal of the proceeding is to maximize the recovery by creditors and shareholders by preserving it as a viable entity with a going concern value. For that purpose, the entity prepares a **plan** of reorganization intended to be confirmed by the court. The plan provides for treatment of all the assets and liabilities of the debtor, which might result in forgiveness of indebtedness. For the plan to be confirmed and the reorganization proceedings thereby concluded, the consideration 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 court may confirm a plan even if some classes of creditors or some of the stockholders have not accepted it, provided that it meets standards of fairness required by Chapter 11 to the dissenting classes of creditors or the dissenting stockholders.

3. The plan is the heart of every Chapter 11 reorganization. The provisions of the plan specify the treatment of all creditors and equity holders upon its approval by the Bankruptcy Court. Moreover, the plan shapes the financial structure of the entity that emerges.

4. Chapter 11 provides that, unless a **trustee** is appointed, the debtor has the exclusive right to file a plan for the first 120 days of the case, or such longer or shorter time as the Bankruptcy Court decrees, for cause. If a plan is filed within the exclusive period, additional time is provided to allow the debtor to obtain plan acceptance. The appointment of the trustee immediately terminates the debtor's exclusive right to file a plan, and any party in interest may then do so.

5. Except to the extent that specific debts are determined by the Bankruptcy Court to not be discharged by the plan, the provisions of a **confirmed plan** bind the debtor, any entity issuing securities under the plan, any entity acquiring assets under the plan, and any creditor, equity security holder, or general partner

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1 Appendix C presents a glossary of defined terms, which are in bold type when they first appear in the text.

in the debtor, regardless of whether the **claim** is impaired under the plan and whether such creditor, equity security holder, or general partner has accepted the plan. A claim is impaired if, subject to certain rights to cure defaults, its legal rights are affected adversely by the plan.

6. In general, except as provided in the plan or in the order confirming the plan, confirmation of the plan discharges the debtor from all preconfirmation claims and terminates all rights and interest of equity security holders or general partners as provided for in the plan.

7. The Bankruptcy Court confirms a plan if it finds all of the following:

- The plan and the plan proponent have complied with various technical requirements of the Bankruptcy Code
- Disclosures made in soliciting acceptance of the plan have been adequate
- 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
- Claims entitled to priority under the Bankruptcy Code will be paid in cash
- Confirmation of the plan is not likely to be followed by liquidation or further reorganization
- At least one class of impaired claims has accepted the plan apart from acceptances of insiders
- 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 or impaired claims or equity security holders 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.)

8. In general, 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. In general, an **unsecured claim** is deemed to be treated fairly and equitably if it receives assets whose discounted value equals the allowed amount of the claim, or the holder of any claim or equity security interest that is junior to the dissenting class will not receive or retain any assets under the plan. Similarly, an equity security interest is deemed fairly and equitably treated if 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, or no junior equity security interest will receive any assets under the plan.

Reorganization Value

9. An important part of the process of developing a plan is the determination of the **reorganization value** of the entity that emerges from bankruptcy. Reorganization value generally approximates fair value of the entity before

considering liabilities and approximates the amount a willing buyer would pay for the assets of the entity immediately after the restructuring. The reorganization value of an entity is 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. Reorganization value includes the sum of the value attributed to the reconstituted entity and other assets of the debtor that will not be included in the reconstituted entity. Reorganization value and the terms of the plan are determined only after extensive arms-length negotiations or litigation between the interested parties. Before the negotiations, the debtor-in-possession, creditors, and equity holders develop their own ideas on the reorganization value of the entity that will emerge from Chapter 11. Several methods are used to determine the reorganization value; however, generally it is determined by discounting future cash flows for the reconstituted business that will emerge from Chapter 11 and from expected proceeds or collections from assets not required in the reconstituted business, at rates reflecting the business and financial risks involved. In some situations, the fair value of the liabilities and equity securities in the restructured entity may better indicate the entity's reorganization value.

The Disclosure Statement

10. A **disclosure statement** approved by the court is transmitted to all parties entitled to vote on the plan at or before the time their acceptance of the plan is solicited. The disclosure statement provides information that enables them to make informed judgments about the plan.

11. No postpetition solicitation of acceptance of a plan may be made unless by the time of the solicitation a disclosure statement previously approved by the Bankruptcy Court has been sent to those whose acceptance is required. The disclosure statement must contain adequate information, which is defined in the Bankruptcy Code 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. Examples of the kinds of items that may be included in disclosure statements to provide such information include a summary of the reorganization plan, historical and prospective financial information, and a pro forma balance sheet reporting the reorganization value and the capital structure of the emerging entity.

12. What constitutes adequate information depends on the circumstances of the entity in Chapter 11, the nature of the plan, and the sophistication of the various classes whose acceptance is required. Although a valuation is not required for a Bankruptcy Court's approval of a disclosure statement, the instances in which valuations are not made are generally restricted to those in which the reorganization value of the emerging entity is greater than the liabilities or in which holders of existing voting shares retain more than 50 percent of the emerging entity's voting shares when the entity emerges from reorganization.

13. Although acceptances of a plan may not be solicited without a disclosure statement approved by the court, by any person after reorganization proceedings have started, acceptances obtained before the proceedings started

may be counted if (a) they were solicited in compliance with applicable nonbankruptcy law governing the adequacy of disclosure or (b) there is not any applicable nonbankruptcy law but there was in fact adequate information provided at the time of the prebankruptcy solicitation of acceptances of the plan.

CURRENT LITERATURE AND REPORTING PRACTICES

14. The current financial reporting literature provides no specific guidance for financial reporting by entities in reorganization proceedings. Entities generally continue to apply the financial reporting principles they applied before filing petitions; these principles usually do not adequately reflect all changes in the entity's financial condition caused by the proceeding. The financial statements prepared while they are in Chapter 11 reorganization are therefore not as useful to users of financial statements as they should be. For example, the Bankruptcy Code allows the debtor to reject executory contracts such as leases and take-or-pay contracts. Some entities report the resulting claims at the estimated amounts of the allowed claims, while others report them at the estimated amounts at which they will be settled.

15. Another area in which reporting is diverse during the Chapter 11 reorganization is the classification of liabilities. Some entities report all **prepetition liabilities** as current, whereas others report them as long-term debt or as a separate item between current and long-term liabilities. Financial Accounting Standards Board (FASB) Statement No.6, Classification of Short-Term Obligations Expected to Be Refinanced, states that all short-term obligations resulting from transactions in the normal course of business that are due in customary terms, such as trade payables, advance collections, and accrued expenses, are to be classified as current liabilities. However, Statement No. 6 does not address reporting by entities in Chapter 11 reorganization whose unsecured debt may not be paid without approval of the Bankruptcy Court and therefore may neither be paid within one year, or the operating cycle, if longer, nor satisfied with current assets.

16. Further, the financial reporting literature provides no specific guidance for financial reporting by entities emerging from Chapter 11 reorganization under confirmed plans. As a result, practice is diverse. For example, FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings, in footnote 4, and FASB Technical Bulletin No. 81-6, Applicability of Statement 15 to Debtors in Bankruptcy Situations, indicate that Statement No. 15 does not apply to troubled debt restructurings in which debtors restate their liabilities generally under the purview of the Bankruptcy Court. A majority of reorganizations of businesses result in general restructuring of liabilities, and considerable confusion exists on how to report the restructured liabilities. FASB Interpretation No. 2 states that Accounting Principles Board (APB) Opinion No. 21, Interest on Receivables and Payables, should apply to cases under the Bankruptcy Code. However, that interpretation was superseded by Statement No. 15. An analysis of reporting by entities emerging from bankruptcy indicates that some report their debt at discounted amounts and others follow the guidelines in Statement No. 15.

17. There is no specific guidance on whether an emerging entity should restate assets. For example, some restate their assets - though there generally is no net writeup - through quasi-reorganizations and others do not. An analysis of reporting by emerging entities indicates that some eliminate deficits in their

retained earnings by reducing additional paid-in capital while others retain such deficits.

SCOPE

18. This proposed statement of position applies to financial reporting both by entities that have filed petitions with the Bankruptcy Court and expect to reorganize as going concerns under Chapter 11 and by entities that have emerged from Chapter 11 (emerging entities) under confirmed plans.

19. It does not apply to entities that restructure their debt outside Chapter 11, to governmental organizations, or to entities that liquidate or adopt plans of liquidation under the Bankruptcy Code.

CONCLUSIONS

20. The following is a summary of the conclusions reached by the accounting standards division. They should be read in conjunction with the discussion of conclusions, which follows this summary and explains the basis for the conclusions.

Financial Reporting During Reorganization Proceedings

21. Entering a reorganization proceeding, although a significant event, does not ordinarily affect or change the application of generally accepted accounting principles followed by the entity in the preparation of its financial statements. However, the needs of financial statement users change, and thus changes in the reporting practices previously followed by the entity are necessary.

22. An objective of financial statements issued by an entity in Chapter 11 should be to reflect its financial evolution during the proceeding. For that purpose, the financial statements for periods including and subsequent to filing the Chapter 11 petition should distinguish transactions and events that are directly associated with the reorganization from the ongoing operations of the business.

23. Balance Sheet. The balance sheet of an entity in Chapter 11 should distinguish prepetition liabilities subject to compromise from those that are not, such as fully secured liabilities or **postpetition liabilities**. 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. If there is uncertainty about whether a secured claim is **undersecured**, the entire amount of the claim should be included with prepetition claims subject to compromise; such a claim should not be reclassified unless it is subsequently determined that the claim is not subject to compromise.

24. Prepetition claims that become known after a petition is filed should be reported on the basis of the expected amount of the allowed claims as opposed to the amounts for which such claims may be settled. However, the amounts of some claims may not be subject to reasonable estimation pending negotiation or litigation; such claims should be disclosed in the notes to the financial statements based on the provisions of FASB Statement No. 5, Accounting For Contingencies.

25. Debt discounts or premiums as well as debt issue costs could be viewed as valuations of the related debt. When the debt has become an allowed claim and

the allowed claim differs from the net carrying amount of the debt, the recorded amount should be adjusted to the amount of the allowed claim (thereby adjusting existing discounts or premiums, and deferred issue costs to the extent necessary to report the debt at its allowed amount). The gain or loss resulting from the entries to record the adjustment should be classified as **reorganization items** as discussed in paragraph 27 below. Premiums and discounts as well as debt issuance cost on debts that are not subject to compromise, such as fully secured claims, should not be adjusted.

26. Liabilities subject to compromise should be segregated from those that are not subject to compromise on the balance sheet. The principal categories of the claims subject to compromise should be disclosed in the notes to the financial statements. Liabilities not subject to compromise should be further segregated into current and noncurrent classifications if the entity presents a classified balance sheet.

27. **Statement of Operations**. The statement of operations should portray the results of operations of the reporting entity while it is in Chapter 11. Income, expenses (including professional fees), realized gains and losses, and provisions for losses resulting from the restructuring of the business should be reported separately as reorganization items, except for those required to be reported as discontinued operations in conformity with APB Opinion 30, Reporting the Results of Operations.

28. Some entities defer professional fees and similar types of expenditures until the plan is confirmed and then reduce gain from debt discharge to the extent of the previously deferred expenses. Others accrue professional fees and similar types of expenditures upon the filing of the Chapter 11 petition. Still others expense professional fees and similar types of expenditures as incurred. The task force concluded that professional fees and similar types of expenditures directly relating to the Chapter 11 proceeding do not result in assets or liabilities and thus should be expensed as incurred and reported as a reorganization item.

29. Interest expense should be reported only to the extent that it will be paid during the proceeding or that it is probable that it will be an allowed priority, secured, or unsecured claim. Interest expense is an operating item. The extent to which reported interest expense differs from stated contractual interest should be disclosed. The task force understands that the staff of the Securities and Exchange Commission (SEC) prefers that SEC registrants disclose this parenthetically on the face of the income statement.

30. Interest income earned by an entity in Chapter 11 that it would not have earned but for the proceeding (normally all interest income) should be reported as a reorganization item.

31. **Statement of Cash Flows**. Reorganization items should be disclosed separately in the statement of cash flows. This presentation can be better accomplished by the use of the direct method of presenting the statement. If the indirect method is used, additional disclosure is necessary to meet this objective.

32. **Supplementary Combined Financial Statements**. Consolidated financial statements that include one or more entities in reorganization proceedings and one or more entities not in reorganization proceedings should present, as supplementary information, condensed combined financial statements of the

entities in reorganization proceedings. The combined financial statements should be prepared on the same basis as the consolidated financial statements.

33. Intercompany receivables and payables should be disclosed in the supplementary financial statements. In addition, the propriety of the carrying amounts of intercompany receivables from entities in Chapter 11 should be evaluated.

34. Earnings Per Share. Earnings per share should be reported, when required, in conformity with APB Opinion 15, Earnings Per Share. If it is probable that the plan will require the issuance of common stock or common stock equivalents, thereby diluting current equity interests, that fact should be disclosed.

Financial Reporting When Entities Emerge From Chapter 11 Reorganization

35. Entities whose plans have been confirmed by the court and have thereby emerged from Chapter 11 should apply the reporting principles in the following paragraphs as at the confirmation date or as at a later date when all material conditions precedent to the plan becoming binding are resolved.

36. **Fresh Start Reporting**. If 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 if holders of existing voting shares immediately before confirmation receive less than 50 percent of the voting shares of the emerging entity, the entity should adopt fresh start reporting upon its emergence from Chapter 11. The loss of control contemplated by the plan must be substantive and not temporary. That is, the new controlling interest must not revert to the shareholders existing either immediately before the plan was filed or confirmed.

37. While the court determines the adequacy of the disclosure statement, entities that expect to adopt fresh-start reporting should report information about the reorganization value in the disclosure statement, so that creditors and stockholders 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 difference of the total reorganization value of the emerging entity over recorded amounts. When possible, reorganization value should be segregated into major categories.

38. Entities that adopt fresh-start reporting in conformity with paragraph 36 should allocate the reorganization value among their assets in conformity with the following principles:

- The reorganization value of the entity should be allocated to the entity's assets in conformity with the procedures specified by APB Opinion 16, Business Combinations, for transactions reported on the basis of the purchase method. If any portion of the reorganization value cannot be attributed to specific tangible or identified intangible assets of the emerging entity, such amounts should be reported as the

intangible asset, "reorganization value in excess of amounts allocable to identifiable assets." This excess should be amortized in conformity with APB Opinion 17, Intangible Assets. There usually are overriding pertinent factors that should be considered in determining the proper amortization period of this asset that would generally result in a useful life of substantially less than forty years. At a minimum, the same considerations used in determining the reorganized value should be applied in determining the period of amortization.

- Each liability existing at the plan confirmation date, other than deferred taxes, should be stated at its fair value. The fair value should be determined in the same manner as it is determined for a note issued in a noncash transaction under APB Opinion 21, Interest on Receivables and Payables.

- Deferred taxes should be reported in conformity with FASB Statement No. 96, Accounting for Income Taxes. Benefits realized from prior net operating loss carryforwards should first reduce reorganization value in excess of amounts allocable to identifiable assets, and other intangibles, until exhausted and thereafter be reported as a reduction of income tax expense.

- Changes in accounting principles that will be required in the financial statements of the emerging entity within the twelve months following the adoption of fresh start reporting should be adopted at the time fresh start reporting is adopted.

39. The financial statements of the entity as of and for the period immediately preceding the date determined in conformity with the guidance in paragraph 35 should reflect all activity through that date in conformity with the guidance in paragraphs 21 through 34. Additionally, the effects of the adjustments on the reported accounts of individual assets and liabilities resulting from the adoption of fresh start reporting and the effects of the forgiveness of debt should be reflected in the predecessor entity's final statement of operations. Adopting fresh start reporting results in a new reporting entity with no beginning retained earnings or deficit. When fresh start reporting is adopted, the notes to the initial financial statements should disclose the following:

- Adjustments to the historical amounts of individual assets and liabilities

- The amount of debt forgiveness

- The amount of prior retained earnings or deficit eliminated

- Significant matters relating to the determination of reorganization value such as:

    - 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

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

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

40. **Comparative Financial Statements**. Chapter 2A of Accounting Research Bulletin (ARB) No. 43, Restatement and Revision of Accounting Research Bulletins, states the following in paragraph 1:

> The presentation of comparative financial statements in annual and other reports enhances the usefulness of such reports and brings out more clearly the nature and trends of current changes affecting the enterprise.

Paragraph 3 of that chapter requires comparative financial statements that are presented to be comparable from year to year, with any exceptions to comparability being clearly disclosed. Fresh start financial statements prepared by entities emerging from Chapter 11 will not be comparable with those prepared before their plans were confirmed because they are, in effect, those of a new entity. Thus, comparative financial statements that straddle a confirmation date should not be presented.[2]

41. **Reporting by Entities Not Qualifying for Fresh Start**. Entities emerging from Chapter 11 that do not meet the criteria in paragraph 36 do not qualify for a fresh start. The amount at which to report liabilities compromised by confirmed plans should be determined the way a note issued in a noncash transaction is determined under APB Opinion 21. Forgiveness of debt, if any, should be reported as an extraordinary item.

42. Because this proposed statement of position applies financial reporting for entities that enter and intend to emerge from Chapter 11 reorganization, quasi reorganization accounting should not be used at the time of the reorganization.

EFFECTIVE DATE AND TRANSITION

43. This statement of position shall become effective for financial statements of enterprises that have filed petitions under the Bankruptcy Code in their fiscal years beginning after December 15, 1990, or that had plans of reorganization confirmed after December 31, 1991. Earlier application by entities in reorganization is encouraged.

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2. The SEC and other regulatory agencies may require the presentation of predecessor financial statement. However, such presentations should not be viewed as a continuum because the financial statements are those of a different reporting entity and are prepared using a different basis of accounting, and, therefore, are not comparable. Attempts to disclose and explain exceptions that affect comparability would likely result in reporting that is so unwieldy it would not be useful.

DISCUSSION OF CONCLUSIONS

Reporting Prepetition Liabilities

44. The task force believes that entities in Chapter 11 reorganization should segregate liabilities subject to compromise from those that are not subject to compromise. Therefore, prepetition liabilities that may be impaired by a plan and that are eligible for compromise because they are either unsecured or undersecured should be separately classified and designated in the balance sheet as prepetition liabilities subject to compromise, because that provides the most meaningful presentation while in Chapter 11 reorganization.

45. The financial reporting literature does not specifically address the balance sheet classification issues that result from filing a petition. Guidance for classifying liabilities as current in a classified balance sheet is provided in paragraph 7 of ARB 43, chapter 3A, which states the following:

> The term current liabilities is used to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classified as current assets, or the creation of other current liabilities . . .

Trade payables that are incurred in the normal course of business are usually classified as current in classified balance sheets because they meet the ARB No. 43 criteria cited above for such classification. However, filing a petition generally causes the payment of unsecured or undersecured prepetition liabilities to be prohibited before the plan is confirmed. The Chapter 11 reorganization ending in confirmation of a plan typically takes more than one year or one operating cycle, if longer.

46. It might be argued that prepetition liabilities classified as current in a classified balance sheet, such as trade payables, should retain that classification under the provisions of FASB Statement No. 6, Classification of Short-Term Obligations Expected to . Be Refinanced. That Statement requires all short-term liabilities incurred in the normal course of business and due in customary terms to be classified as current. Other short-term liabilities are excluded from the current liability classification under FASB Statement No. 6 if the entity intends to refinance the obligations on a long-term basis and such intent is supported by the facts. However, FASB Statement No. 6 does not address what occurs when a petition is filed.

47. FASB Statement No. 78, Classification of Obligations That Are Callable by the Creditor, amended paragraph 7 of ARB 43, chapter 3A, by requiring current liability classification in a classified balance sheet for long-term liabilities that, by their terms, are due on demand or will be due on demand within one year or the operating cycle, if longer. This definition also includes long-term liabilities that are or will be callable by the creditor because of a violation of a provision of the debt agreement. The **automatic stay provisions** of Chapter 11 makes it unnecessary to reclassify prepetition long-term liabilities even though prepetition creditors might demand payment or there is a violation of a covenant in the debt agreement.

48. Prepetition liabilities should be reported at the amounts of allowed claims, that is, at the amount allowed by the court, even though such liabilities may not be paid in full.

49. When prepetition claims become known after a petition is filed, for example, a claim resulting from the rejection of an operating lease, they should be reported at the estimated amounts of the allowed claims. Some believe that such prepetition claims should be reported at estimates of the settlement amounts. However, these prepetition claims should be reported at the amounts allowed by the court to be consistent with the amounts at which other prepetition liabilities are stated in order to provide comparability among the various kinds of claims.

Statement of Operations

50. Losses as a result of restructuring or disposal of assets directly related to reorganization proceedings are best included as reorganization items to the extent that they are not otherwise reported as part of the results of discontinued operations in conformity with APB Opinion 30, Reporting the Results of Operations. That does not result in reclassification of revenues and expenses from operations sold or abandoned, except those that meet the criteria in APB Opinion 30. Rather, gains or losses classified as reorganization items might include a gain or loss on disposal of assets plus related employee costs and charges or other assets directly related to the assets disposed of or the operations restructured. Also, income, expenses, realized gains, and losses that can be directly associated with the proceeding are best segregated and presented as reorganization items in the statement of operations. Examples include interest income, as indicated in paragraph 30, professional fees, and losses on executory contracts.[3]

51. The task force believes that segregation of reorganization items provides meaningful disclosure and is consistent with APB Opinion 30, paragraph 26 which states the following:

> A material event or transaction that is unusual in nature or occurs infrequently but not both, and therefore does not meet both criteria for classification as an extraordinary item, should be reported as a separate component of continuing operations.

Interest Expense

52. Certain provisions of the Bankruptcy Code may relieve the entity from its obligation to pay interest. Generally, interest on secured claims accrues only to the extent that the value of underlying collateral exceeds the principal amount of the secured claim. In addition, interest on unsecured claims does not accrue during the proceeding if the entity is insolvent; therefore, disclosure of contractual interest is considered useful because it may differ from interest actually being reported.

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3 Appendix A illustrates consolidated statements of operations that include reorganization items.

Interest Income

53. An entity in reorganization typically accumulates cash during the proceeding, because it is not paying its obligations currently. The cash is ultimately distributed to creditors or others in conformity with the plan. The amount of cash accumulated does not reflect the entity's prepetition activities, and it is not expected that such an accumulation would recur in the reorganized entity. The interest income earned during the proceeding on cash accumulated during the proceeding, therefore, is a reorganization item. To the extent that management can reasonably estimate that portion of interest income applicable to normal invested working capital, it should be reported as an operating item in the ordinary manner.

Statement of Cash Flows

54. FASB Statement No. 95, Statement of Cash Flows, requires information on the cash activity of reporting entities. The task force believes that such information is the most beneficial information that can be provided in the financial statements of an entity in Chapter 11. It also believes the direct method is the better method to provide such information by such entities.

55. Paragraph 27 of FASB Statement No. 95 lists the operating items that should be reported separately when the direct method is used. That paragraph encourages further breakdown of those operating items if the entity considers such breakdown meaningful and it is feasible to do so. Further identification of cash flows from reorganization items should be provided to the extent feasible. For example, interest received might be segregated between estimated normal recurring interest received and interest received on cash accumulated because of the reorganization. Appendix A illustrates a statement of cash flows for an entity operating under Chapter 11.

56. If the indirect method of reporting net cash flows from operating activities is used, details of operating cash receipts and payments resulting from the reorganization should be disclosed in a supplementary schedule or in the notes to the financial statements.

Fresh Start Reporting

57. The effects of a plan should be included in the entity's financial statements as of the date the plan is confirmed. However, inclusion should be delayed to a date not later than the effective date if there is a material unsatisfied condition precedent to the plan becoming binding on all the parties in interest or if there is a stay pending appeal. That might occur, for example, if obtaining financing for the plan or the transfer of material assets to the debtor by a third party is a condition to the plan becoming effective.

58. Financial statements prepared as of a date after the parties in interest have approved a plan through the voting process, and issued after the plan has been confirmed by the court, should report the effects of the plan if there are no material unsatisfied conditions.

59. An essential element in negotiating a plan with the various classes of creditors and equity interests is the determination of reorganization value by the parties in interest. The plan provides for allocating the reorganization value

among the parties in interest in accordance with their legal priorities: First to secured claims to the extent of the value of the collateral securing the claims, then to claims entitled to priority under the Bankruptcy Code, and then to the various classes of unsecured debt and equity interests in accordance with their legal priorities or as the parties may otherwise agree. In the event that the parties in interest cannot agree on the reorganization value and presumably the plan of reorganization, then the court may be called upon to determine the reorganization value of the entity before a plan of reorganization can be confirmed.

60. The task force concluded that reorganization value can be a more objective measure of fair value than a purchase price in a business combination. This view is based on two factors. First, a purchase price in a nonbankruptcy business combination may exceed the fair value of the acquired entity, because such determinations may be influenced by a variety of factors unrelated to that entity. Second, in the reorganization process, extensive information available to the parties in interest, the adversarial negotiation process, the involvement of the Bankruptcy Court, the use of specialists by one or more of the parties at interest, and the fact that all elements of the determination are focused solely on the economic viability of the emerging entity result in an objective and reliable determination of reorganization value.

61. If, based on reorganization value, the parties in interest allow the entity to survive as a going concern and emerge from Chapter 11, the financial reporting should reflect that fact. The ability to reflect reorganization value would enhance the representational faithfulness of the emerging entity's financial statements.

62. Under the **absolute priority doctrine** of the Bankruptcy Code, if the amount of postpetition liabilities and allowed claims exceeds the reorganization value of the emerging entity, existing shareholders lose their legal right to any economic interest without the consent of creditor interests. Therefore, any equity interest in the emerging entity ultimately held by existing shareholders is given to them by the creditors. Among the reasons the creditors might give such shareholders equity interests in the emerging entity are to avoid the expensive and time-consuming legal proceedings necessary to implement the cram-down provisions of the Bankruptcy Code or to preserve continuity of management.

63. Based on the factors described in paragraphs 59, 60, and 62, some would conclude that the combination of change in majority ownership and voting control -- that is, loss of control by the existing shareholders, a court-approved reorganization, and a reliable measure of the entity's fair value -- results in a fresh start, creating, in substance, a new reporting entity. Others believe that a change in control and the exchange of debt and equity based on reorganization value is in substance an acquisition at fair value by new shareholders in exchange for extinguishing their debt. Although the former shareholders can receive a portion of the new equity, they have lost their rights to any equity interest in the reorganized entity and receive such interest only with the consent of the real stakeholders, the creditors who will become the new shareholders. The task force concluded that under each view a new reporting entity is created and assets and liabilities should be recorded at their fair values. That is, assets should be recorded on the basis of reorganization value and liabilities should be recorded at fair value.

64. Some believe that the recognition of reorganization value in the balance sheet of an emerging entity that meets the criteria for fresh-start reporting should be limited to no net write-up of assets, similar to the SEC staff's interpretation of FRR Section 210 (ASR 25). That view is a combination of the notion that assets and liabilities should be reported at fair value in a fresh start and the belief that assets cannot be written up in a historical cost transaction-based accounting model. The task force did not accept that view for the reasons stated in paragraph 63.

Fair Value of Liabilities

65. In a typical Chapter 11 reorganization, there is a general restructuring of liabilities. FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings, does not apply in a general restructuring of liabilities.

66. A general restructuring of liabilities involves negotiation between the parties in interest. The negotiation and distribution under the confirmed plan constitutes an exchange of resources and obligations. By analogy, the guidance provided by APB Opinion 21 for the discounted amount of a note issued in a noncash transaction should be applied in reporting liabilities by an entity in Chapter 11.

Analogous Literature

67. The task force believes that the principles of quasi-reorganization accounting are not applicable to Chapter 11 reorganizations. Some argue that such a requirement would conflict with ARB 43 because it would prohibit adopting an accounting procedure that is now generally accepted. The task force does not believe that is the case. ARB 43 relates to a procedure called a quasi-reorganization. Webster's dictionary defines quasi as "having some resemblance." The task force interprets ARB 43 to apply to situations that resemble but are not reorganizations under Chapter 11. There is no specific guidance for a legal reorganization, so practice has sometimes looked to ARB 43 when reporting a legal reorganization. The task force believes that is the case with many emerging entities. This proposed statement of position provides specific guidance for all reorganizations under Chapter 11, and an analogy to ARB 43 is not appropriate.

APPENDIX A ILLUSTRATIVE FINANCIAL STATEMENTS AND FOOTNOTE DISCLOSURE FOR AN ENTITY OPERATING UNDER CHAPTER 11

XYZ Company is 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 of the federal bankruptcy laws. The following financial statements (balance sheet and statements of operations and cash flows) are presented as of and for the year ended December 31.

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

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

Liabilities and Shareholders' 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
Shareholders' (deficit):	
Preferred stock	325
Common stock	75
Retained earnings (deficit)	(445)
	(45)
Total Liabilities & Shareholders' (Deficit)	$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.

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	$ (.62)
Discontinued operations	(.56)
Net loss	$ (1.18)

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

XYZ COMPANY
(DEBTOR-IN-POSSESSION)
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 19X1
Increase in Cash and Cash Equivalents
(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 flows 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 overdraft at beginning of year	-
Cash and cash equivalents at end of year	$ 110
Reconciliation of net income 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
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.

XYZ COMPANY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 19X1

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 prior to 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 subsequent to the filing date resulting from rejection of executory contracts, including leases, and from the determination by the court (or agreed to by the 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 amount to $5,000, which is $2,000 in excess of reported interest expense; therefore, the Debtor has discontinued accruing interest on these obligations. Refer to Note XX (see Appendix B, Note X) for a discussion of the credit arrangements entered into subsequent to the Chapter 11 filings.

APPENDIX B FRESH START ACCOUNTING AND ILLUSTRATIVE NOTES TO FINANCIAL STATEMENTS

1B. 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 consists 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 percent of the voting shares of the emerging entity and its reorganization value is less than its postpetition liabilities and allowed claims, as shown below:

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

2B. 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 the following:

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

2C. 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 reorganized capital structure should be as follows:

Postpetition current liabilities	$ 300,000
IRS Note	50,000
Senior debt	275,000 (1)
Subordinated debt	175,000
Common stock	350,000
	$ 1,150,000 (2)

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

(2) See paragraph 2E for the balance sheet adjustments required to reflect XYZ Company's reorganization value as of the date of plan confirmation.

2D. The following entries record the provisions of the plan and the adoption of fresh start reporting:

Entries to record debt discharge:

Account	Debit	Credit
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:

Account	Debit	Credit
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:

Account	Debit	Credit
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

2E. The effect of the plan of reorganization on XYZ Company's balance sheet, as of June 30, 19X2, is as follows:

	Pre-confirmation	ADJUSTMENTS TO RECORD CONFIRMATION OF PLAN: Debt Discharge	Exchange of Stock	Fresh Start	XYZ Company's Reorganized Balance Sheet
Assets:					
Current Assets					
Cash	$200,000	$(150,000)			$ 50,000
Receivables	250,000				250,000
Inventory	175,000			$50,000	225,000
Assets to be disposed of valued at market which is lower than cost	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 to be disposed of valued at market, which is lower than cost	50,000				50,000
Goodwill	200,000			(200,000)	
Reorganization value in excess of amounts allocable to identifiable assets	0			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)		0
Additional paid-in-capital		215,000	386,000	(351,000)	250,000
Common stock - old	75,000		(75,000)		0
Common stock - new		86,000	14,000		100,000
Retained earnings (deficit)	(700,000)	149,000		700,000 (149,000)	0
	(300,000)	450,000	0	200,000	350,000
	$ 1,100,000	($150,000)	$ 0	$200,000	$ 1,150,000

2F. The following illustrates footnote disclosure, which 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 footnote. 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 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: a) $87,000 in new senior secured debt, payable in annual installments of $15,800 commencing on March 1, 19X3, through March 1, 19X6, with interest at 12% per annum, secured by first liens on certain property, plant, and equipment, with the balance due on March 1, 19X7; b) $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 c) 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: a) $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, plant, and equipment, with the balance due on March 1, 19X7; b) $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 c) 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 of outstanding voting common stock of the Company.

Preferred Stock -- The holders of 3,250 shares of preferred stock received 12 percent 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 of 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 Company accounted for the reorganization using fresh start accounting. Accordingly, all assets and liabilities are restated to reflect their reorganization value, which approximates fair value at the date of reorganization. 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.

XYZ COMPANY
PLAN OF REORGANIZATION
RECOVERY ANALYSIS

		Recovery (†)									
		Elimination of Debt and Equity	Surviving Debt	Cash	IRS Note	Senior Debt	Subordinated Debt	Common Stock †		Total Recovery	
								%	Value	$	%
Postpetition liabilities	$ 300,000		$ 300,000							$ 300,000	100%
Claim/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%	$ 350,000	$ 1,300,000	

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

APPENDIX C GLOSSARY

Automatic stay provisions. Provision causing the filing of a petition under the Bankruptcy Code to automatically stay virtually all actions of creditors to collect prepetition debts. As a result of the stay, no party, with minor exceptions, having a security or adverse interest in the debtor's property can take any action that will interfere with the debtor or his property, regardless of where the property is located or who has possession, until the stay is modified or removed.

Absolute priority doctrine. A doctrine that provides that if an impaired class does not vote in favor of a plan, the court may nevertheless confirm the plan under the cram-down provisions of the Code. The absolute priority doctrine is triggered when the cram-down provisions apply. The 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.

Administrative expenses (claims). Claims that receive priority over all other unsecured claims in a bankruptcy case. Administrative claims (expenses) include the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case. Fees paid to professionals for services rendered after the petition is filed are considered administrative expenses.

Allowed claim(s). The amount allowed by the Court as a claim against the Estate. This amount may differ from the amount the liability is settled for.

Bankruptcy Code. A federal statute, enacted October 1, 1979, as title 11 of the United States Code by the Bankruptcy Reform Act of 1978, that applies to all cases filed on or after its enactment and that provides the basis for the current federal bankruptcy system.

Bankruptcy Court. The United States Bankruptcy Court is an adjunct of the United States District Courts. Under the jurisdiction of the District Court, the Bankruptcy Court is generally responsible for cases filed under Chapters 7, 11, 12, and 13 of the Bankruptcy Code.

Chapter 7 proceeding. A liquidation, voluntarily or involuntarily initiated under the provisions of the Bankruptcy Code, that provides for liquidation of the business or debtor's estate.

Chapter 11 proceeding. A reorganization action either voluntarily or involuntarily initiated under the provisions of the Bankruptcy Code that provides for a reorganization of the debt and equity structure of the business and allows the business to continue operations. A debtor may also file a plan of liquidation under Chapter 11.

Claim. As defined by Section 101(4) of the Bankruptcy Code, (a) a right to payment, regardless of whether the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, secured, or unsecured, or (b) a right to an equitable remedy for breach of performance if such breach results in a right to payment, regardless of whether

the right is reduced to a fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured right.

Confirmed plan. An official approval by the court of a plan of reorganization under a Chapter 11 proceeding that makes the plan binding on the debtors and creditors. Before a plan is confirmed, it must satisfy eleven requirements in section 1129(a) of the Bankruptcy Code.

Consenting classes. Classes of creditors or stockholders that approve the proposed plan.

Cram-down provisions. Provisions requiring that for a plan to be confirmed, a class of claims or interests must either accept the plan or not be impaired. However, the Bankruptcy Code allows the Court under certain conditions to confirm a plan even though an impaired class has not accepted the plan. To do so, the plan must not discriminate unfairly and must be fair and equitable, to each class of claims or interests impaired under the plan that have not accepted it. The Code states examples of conditions for secured claims, unsecured claims, and stockholder interests in the fair and equitable requirement.

Debtor-in-possession. Existing management continuing to operate an entity that has filed a petition under Chapter 11. The debtor-in-possession is allowed to operate the business in all Chapter 11 cases unless the court, for cause, authorizes the appointment of a trustee.

Disclosure statement. A written statement containing information approved as adequate by the court. It is required to be presented by a party before soliciting the acceptance or rejection of a plan of reorganization from creditors and stockholders affected by the plan. Adequate information means information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's records, 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.

Emerging entity (reorganized entity). An entity that has had its plan confirmed and begins to operate as a new entity.

Impaired claims. In determining which class of creditors' claims or stockholders' interests must approve the plan, it is first necessary to determine if the class is impaired. A class of creditors' claims or stockholders' interests under a plan is not impaired if the plan (a) leaves unaltered the legal, equitable, and contractual right of a class, (b) cures defaults that lead to acceleration of debt or equity interest, or (c) pays in cash the full amount of the claim, or for equity interests, the greater of the fixed liquidation preference or redemption price.

Nonconsenting class. A class of creditors or stockholders that does not approve the proposed plan.

Obligations subject to compromise. Includes all prepetition liabilities (claims) except those that will not be impaired under the plan, such as claims where the value of the security interest is greater than the claim.

Petition. A document filed in a court of bankruptcy, initiating proceedings under the Bankruptcy Code.

Plan (Plan of reorganization). An agreement formulated in Chapter 11 proceedings under the supervision of the Bankruptcy Court that enables the debtor to continue in business. The plan, once confirmed, may affect the rights of undersecured creditors, secured creditors, and stockholders as well as those of unsecured creditors. Before a Plan is confirmed by the Court, it must comply with general provisions of the code. Those provisions mandate, for example, that (a) the plan is feasible, (b) the plan is in the best interest of the creditors, and, (c) if an impaired class does not accept the plan, the plan must be determined to be fair and equitable before it can be confirmed.

Postpetition Liabilities. Liabilities incurred subsequent to the filing of a petition that are not associated with prebankruptcy events. Thus, these liabilities are not considered prepetition liabilities.

Prepetition Liabilities. Liabilities that were incurred by an entity prior to its filing of a petition for protection under the Code, including those considered by the bankruptcy court to be prepetition claims, such as a rejection of a lease for real property.

Reorganization items. Items of income, expense, gain, or loss that are realized or incurred by an entity because it is in reorganization.

Reorganization proceeding. A Chapter 11 case from the time at which the petition is filed until the plan is confirmed.

Reorganization value. The value attributed to the reconstituted entity, as well as the expected net realizable value of those assets that will be disposed before reconstitution occurs. Therefore, this value is viewed as the fair value of the entity before considering liabilities and approximates the amount a willing buyer would pay for the assets of the entity immediately after the restructuring.

Secured claim. A liability that is secured by collateral. A fully secured claim is one where the value of the collateral is greater than the amount of the claim.

Trustee. A person appointed by the Bankruptcy Court in certain situations based on the facts of the case, not related to the size of the company or the amount of unsecured debt outstanding, at the request of a party in interest after a notice and hearing.

Undersecured liability (claim). A secured claim whose collateral is worth less than the amount of the claim.

Unsecured liability (claim). A liability that is not secured by collateral. In the case of an undersecured creditor, the excess of the secured claim over the value of the collateral is an unsecured claim, unless the debtor elects in a Chapter 11 proceeding to have the entire claim considered secured. The term is generally used in bankruptcy to refer to unsecured claims that do not receive priority under the Bankruptcy Code.