

Case 12-10

Acquisition of Legal Subsidiary in Bankruptcy

Parent Co. (Parent) is a nonpublic company with two wholly owned subsidiaries, Poor Son Co. (Poor Son), a nonpublic company, and Rich Grandson Co. (Rich Grandson), a public entity registered with the SEC. Rich Grandson was transferred to Parent by Poor Son in 2006. Parent, Poor Son, and Rich Grandson each prepare stand-alone financial statements in accordance with U.S. GAAP. This case addresses the accounting by Parent and Poor Son and does not address any accounting associated with Rich Grandson.

Bankruptcy

In January 2007, Poor Son filed a voluntary petition for reorganization under Chapter 11 of the U.S. bankruptcy code because of its inability to meet obligations as they became due. Specifically, Poor Son incurred significant levels of bank debt in prior years, and because of deteriorating business conditions, was no longer able to support that level of debt. Parent concluded that as a result of the bankruptcy, it lost control of Poor Son and deconsolidated Poor Son from its financial statements. Parent cited the following to support a loss of control:

- The bankruptcy court imposed a corporate governance stipulation under which Parent lost its ability to unilaterally remove and replace three out of the five members comprising Poor Son's board of directors.
- In 2008, Poor Son filed an action against Parent seeking to void the transfer of Rich Grandson as a fraudulent transfer, and seeking the return of its interest in Rich Grandson as well as any dividends it would have received on Rich Grandson shares since the transfer occurred.
- Poor Son terminated all of Parent's employees that were providing management and technical assistance on operations and business matters to Poor Son.

In May 2009, the bankruptcy court held a selection meeting in which it considered competing plans of reorganization submitted by four bidders, which included Parent. OtherCo, an unrelated party to Parent, Poor Son, or Rich Grandson, was also one of the four bidders. Management of Poor Son backed OtherCo's plan, and in June 2009, the bankruptcy court announced OtherCo as the winning plan sponsor. The joint plan of reorganization filed by Poor Son and OtherCo was valued at approximately \$1 billion.

In the months immediately following the submission of the joint OtherCo and Poor Son plan, the enterprise value of Poor Son declined significantly because of external economic conditions, thus prompting OtherCo to rescind its offer and seek a reduction in the value of the consideration offered for Poor Son. In response, the bankruptcy court reopened the bidding process and allowed Parent to file a competing plan and solicit acceptances thereof.

In August 2010, the bankruptcy court recommended that the district court confirm Parent's plan of reorganization and determined that such plan met all the requirements of

the bankruptcy code for confirmation. Upon execution of Parent's plan, Parent would receive 100 percent of the new equity interests in "Reorganized Poor Son" and would name all members of Poor Son's new five-member board of directors. In November 2010, Parent received final confirmation of Poor Son's plan.

Required:

1. Does Parent's purchase of a legal subsidiary in bankruptcy qualify as a business combination under ASC 805?
2. If Parent's purchase of a legal subsidiary in bankruptcy qualifies as a business combination under ASC 805, what would be the acquisition date?
3. Should Poor Son apply "fresh-start" reporting under ASC 852?
4. May Parent "push down" its new basis in Poor Son for Poor Son's standalone financial statements?