Arthur
Andersen

Accounting for Business Combinations

Interpretations of APB Opinion No. 16,
Business Combinations

Ninth Edition

Accounting Transactions Series

__________ Exhibit No. 733
Date 7-14-00 Case No. EM-2000-292
Reporter DURBIN

48c-8. Measuring the Significance of Asset Disposals

In measuring the significance of asset disposals (whether such disposals are by sale or abandonment), we would look at the following factors generally used to evaluate the significance of disposals as of the consummation date:

1. The amount of net assets to be disposed of or sold relative to the net assets of the combining company that intends to make the disposal, on both a book value and market value basis.

2. The proportional revenues of the business being disposed relative to the combining company's revenues.

3. The earnings (i.e., operating income or some analogous measure) of the business being disposed relative to that of the combining company.

4. The gain or loss to be recognized on the disposition of the asset or business relative to the earnings or loss of the combining company.

The significance tests should be performed in relation to the historical financial statements of the company out of which the disposal is made. Generally, the tests should be made on the financial statements for the most recent fiscal year prior to the consummation date. A disposal would be considered significant if any of the measurements were ten percent or more.

The SEC staff has indicated that it uses a substantially similar approach, assessing significance on several different factors involving both balance sheet and income statement measurements, and generally using ten percent to measure "significance."

For example, assume that Company A and Company B combine, and the combined AB plans to dispose of some of former Company A's assets and some of former Company B's assets. The test of significance for the disposition of Company A assets should be in relation to the financial statements of Company A and the test of significance for the disposition of Company B assets should be in relation to the financial statements of Company B. In particular, those financial statements are the most recent annual financial statements of each respective company that are available at the consummation date of the business combination.

The test of significance should be made (a) individually for each disposal, and (b) in the aggregate for all disposals from the same company. The test should not be done in the aggregate for disposals from different combining companies. When aggregating disposals under the revenue and asset tests, all disposals out of the same company will be aggregated together. However, when aggregating disposals under the income and gain/loss tests, it is not appropriate to aggregate positive amounts (income and/or gains) with negative amounts (losses).

For example, Company A plans to dispose of assets it owned prior to consummation, for example assets X, Y, and Z. Assume that the highest of the four tests of significance is the gain/loss test. Specifically, the disposals would result in a gain of 6 percent, a loss of five percent and a gain of four percent, respectively. Company A would meet the test on an individual asset disposal basis since no individual disposal equals or exceeds the ten percent threshold. The question is how should the disposals be aggregated to determine whether they violate the ten percent gain/loss test. One reasonable approach would be to follow the guidance in the SEC Staff Training Manual for applying Rule 3.05 of Regulation S-X. Disposals with gains should be aggregated. Likewise, disposals with losses should be aggregated. The total for gains and the total for losses should not be aggregated. Rather, the total for disposals with gains and the absolute value of the total for losses should be separately compared to Company A's net income. In this example, the total of the gains for assets X and Z aggregate ten percent. Accordingly, the aggregate gain/loss test would be violated if the disposal of assets X and Z were both completed. A similar approach could be used for measuring compliance with the income test.

If on the other hand, Company A disposed of only asset X (a gain of six percent on a stand-alone basis) and Company B disposed of only its asset W (a gain of nine percent on a stand-alone basis), the individual tests would have been met as there would be no aggregation because the disposals are from different former companies.