

ARNE & CO.

Business Valuations • Mergers & Acquisitions • Seminars

ROUTE TO:

VALUE ADDED™

DARRELL V. ARNE, President
E-Mail: Darne@Arne-Co.com
Website: www.Arne-Co.com

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5424 Arabian Drive, NW
Albuquerque, New Mexico 87120
Telephone: (505) 898-2514 Telecopier: (505) 899-4476

Shouting from the Rooftops GIFT NOW!

"One year ago if you had bought \$1,000 worth of Nortel stock you would currently have \$47. If you had bought \$1,000 worth of beer in the USA (where cans have a return value), you would currently have \$79 worth of empty beer cans."

— E-mail from a senior investment manager at a major investment banking firm

If you:

- 1) Believe the repeal of the gift tax and estate tax is absolutely going to happen
- 2) Think that the repeal of the repeal will be repealed
- 3) Believe that you absolutely will live to see both of the above occur

Then read no further.

But ... If you:

- 1) Believe in the prosperity of the future of America and the civilized world, and that it is not really any different today than it was before September 11th
- 2) Think that the government may actually have to raise taxes to pay for insuring the future prosperity of America and the civilized world
- 3) Believe that there are opportunities even in difficult times

Then this represents an historic opportunity to make gifts and otherwise taxable transfers of wealth with minimal tax consequences.

We are shouting from the rooftops: GIFT NOW! When the NASDAQ was at 5,000 and the Dow at 11,000 our phones were ringing off the hooks. We are still busy now, but see few clients taking full advantage of the tremendous opportunity that financial (and in some cases, real property) asset deflation has presented to people with estate planning needs.

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Summary of FASB 141 (Business Combinations) and FASB 142 (Goodwill and Other Intangible Assets)

In a long-anticipated pair of Standards issued on June 30, 2001, the Financial Accounting Standards Board (FASB) dramatically rewrote the rules of accounting for business combinations. While it had been known for some time that the pooling of interests accounting treatment for mergers and acquisitions would be eliminated, the Standards also included wholesale modifications to the accounting for goodwill associated with acquisitions under the purchase method of accounting. With over 2,500 public companies reporting goodwill on their balance sheets, the effects of the new Standards will be widely felt. This article presents a brief overview of the new Standards.

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Mergers & Acquisitions Seminar

12/07/01 Buying & Selling a Business
in New Mexico
Lorman Education
Albuquerque, NM

Business Valuation for Bankers

01/24/02 New Mexico Chapter of RMA
Albuquerque, NM

Best Strategies for Successful Small Business Transfers

06/10/02 International Business Brokers Assn.
New Orleans, LA

Tax Boot Camp for the M&A Professional

03/15/02 International Business Brokers Assn.
San Francisco, CA

05/03/02 International Business Brokers Assn.
Chicago, IL

06/11/02 International Business Brokers Assn.
New Orleans, LA

Maximizing the Value of the Closely Held Company

12/04/01 AICPA Business Valuation Conference
Las Vegas, NV

01/17/02 Midwest Business Brokers Assn.
Chicago, IL

03/14/02 International Business Brokers Assn.
San Francisco, CA

05/02/02 International Business Brokers Assn.
Chicago, IL

11/11/02 International Business Brokers Assn.
Los Angeles, CA

Advanced M&A Tax Strategies and Deal Structures

03/15/02 International Business Brokers Assn.
San Francisco, CA

Descriptions of the courses offered
by Darrell Arne can be found
on our website

www.arne-co.com

FASB 141 & 142

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General Overview

- All business combinations must be accounted for using the purchase method; use of the pooling-of-interests method is prohibited.
- At the time of an acquisition, goodwill will continue to be recognized as the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed.
- Intangible assets acquired in a business combination shall be recognized as an asset apart from goodwill if that asset arises from contractual or other legal rights. FASB has provided a list of intangibles that, if acquired in a business combination, would generally meet the criteria for recognition:
 - trademarks, noncompetes, customer lists and relationships, order backlogs
 - creative intangibles such as books, musical compositions, and photographs
 - contract-based intangibles such as licensing agreements, leases, mortgage servicing rights, and timber rights
 - technology-based intangibles such as patented and unpatented technology, domain names, databases, and trade secrets

Amortization and Impairment Testing – Goodwill

- Goodwill should not be amortized, but should be tested for impairment annually at the reporting unit level.
- A reporting unit is the same level as or one level below an operating segment (per FASB No. 131 Segment Reporting).¹
- Nonpublic companies that are not required to report segment information in accordance with FASB

No. 131 are required to test goodwill for impairment at the reporting unit level. An entity may have only one reporting unit, in which case goodwill would be tested for impairment at the entity level.

- Goodwill should be tested for impairment using a two-step approach:
 1. Compare the fair value of the reporting unit to its carrying amount, including its goodwill.²
 2. If fair value is less than carrying amount, compare the implied fair value of goodwill to its carrying amount. Impairment loss is recognized equal to that excess, if any of the carrying amount of goodwill and the implied fair value of the goodwill.
- Impairment losses should be presented as a separate line in the operating section of the income statement.
- The fair value measurement supporting the goodwill impairment test could be performed at any time during the fiscal year as long as that measurement date is used consistently from year-to-year.

Amortization and Impairment Testing – Other Intangibles

- Recognized intangible assets will be classified as having either an indefinite life or a finite life.
- Recognized intangible assets with indefinite lives should not be amortized until its life is determined to be finite. Such intangible assets should, however, be tested for impairment at least annually by comparing the fair value of the intangible asset to its carrying amount.
- Recognized intangible assets with finite lives should be amortized over their useful lives and reviewed for impairment in accordance with FASB No. 121.

Effective Dates

- Effective for fiscal years beginning after December 15, 2001. Retroactive application is not permitted.

- Previously recognized goodwill and other intangibles (arising from acquisitions completed before July 1, 2001) should be accounted for in accordance with the new procedures.
- Companies should perform the first step of the impairment test within six months of initially applying the Statement. For the transitional impairment test, fair value should be measured as of the first of the fiscal year. Impairment loss from the transitional test should be recognized as a change in accounting principle.
- Intangible asset provisions apply to intangible assets recognized separately from goodwill at the date of acquisition.

Required Disclosures

- The primary reason for the acquisition, including a description of the factors that contributed to a purchase price that results in recognition of goodwill.
- For each impairment loss recognized: a description of the facts and circumstances leading to the impairment, the method of determining the fair value of the reporting unit (whether based on quoted market prices, prices of comparable businesses, or a present value or other valuation technique).

Conclusion

For more information about these Standards or to discuss a goodwill impairment issue in confidence, please call us. ♦

Gift Now!

(Continued from Page 1)

How can people think of gift and estate planning in the midst of financial chaos? Exactly! Because it's so difficult, it must be the right thing to do. If everyone is doing it, how can it possibly be the right idea? Well, guess what? They're not! But they should be!

For those of us who like numbers, an illustration (see Table 1):

Assume that, in the Summer of 2000, a scant 18 months ago, a married couple had \$5 million invested in the S&P 500 index. Assume they used that basket of assets to make taxable gifts to their children. Assuming a top gift tax rate of 55% and a joint unified credit of \$1.3 million, they would have paid taxes of over \$2.0 million.

Today, that same basket of stocks that was worth \$5 million last summer is worth about \$3.25 million. Is there a silver lining in the dark cloud of asset deflation? Absolutely. If the same couple gifts those same assets today, under the same assumptions used above, they would pay almost \$1 million less in gift taxes.

Some people don't like to pay gift taxes. For them, asset deflation can be taken advantage of in another way.

We believe it is safe to say that the value of a given asset in, say, 2025, will be the same despite the events of September 11th. If, for example, you assume that \$1 invested in the S&P 500 last summer would increase in value at 10% per year, in 2025 that dollar would be worth \$10.83 (see Table 2).

So, if the same couple, last year, had only gifted their unified credit, they would have gifted, to their children, assets worth \$14.1 million in 2025. Hopefully, their children would be grateful for this. (see Table 3).

Today, however, that dollar invested last year is worth about \$0.65. If it will still be worth \$10.83 in 2025, that implies a rate of return of 12.4% over the next 24 years (see Table 4).

A 2.4 percentage point higher rate of return over 24 years makes a big difference. Thanks to the current level of asset deflation, if the same couple waited until now to use up their unified credit, they would, in fact, be gifting future value of \$21.7 million, over 50% more than they could have gifted

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TABLE 1

\$ of S&P500 at Summer, 2000	\$5,000,000
Unified Credit	<u>\$1,300,000</u>
Taxable Gift	\$3,700,000
Gift Taxes Paid Out of Other Assets on Taxable Gift (at 55%)	
Approximate Value of Same S&P Asset Today	\$3,250,000
Unified Credit	<u>\$1,300,000</u>
Taxable Gift	\$1,950,000
Gift Taxes Paid Out of Other Assets on Taxable Gift (at 55%)	
Difference in Gift Taxes Paid on Gift of Same Assets	

¹ FASB No. 131 defines an operating segment as a component of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance.

² **Fair value** is defined in FASB Statement of Financial Accounting Concepts No. 7 Using Cash Flow Information and Present Value in Accounting Measurements, as the amount at which that asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale.

TABLE 2

Base Value in Summer, 2000	\$1.00
Number of Years	25.00
Rate of Return on Asset	10.0%
Future Value at end of Term (2025)	\$10.83

TABLE 3

Asset Value Received in Summer, 2000	\$1,300,000
Number of Years	25.00
Rate of Return on Asset	10.0%
Asset Value in 2025	\$14,085,111

TABLE 4

Value of S&P 500 in 2025	
Base Value in Fall, 2001	\$0.64
Number of Years	24.00
Rate of Return on Asset	12.4%
Future Value at end of Term (2025)	\$10.83

TABLE 5

Asset Value Received in Fall, 2001	\$1,300,000
Number of Years	24.00
Rate of Return on Asset	12.4%
Asset Value in 2025	\$21,669,411

last year. And, over 50% more than if asset values rebound to previous levels (see Table 5).

Lower taxes. Higher future wealth. Either way you look at it, the current depressed prices of many assets represents a tremendous and unusual opportunity to make gifts. Although these illustrations were made using units of the S&P 500 index, it would be no different gifting interests in other depressed assets, such as shares of closely held companies.

We imagine that combining deflated assets with a variety of sophisticated gift and estate planning techniques makes this even better. But we are not estate planners, just financial analysts who know that there are opportunities during any market condition, especially now.

If you would like to discuss this illustration with regard to a particular matter, please call us. We look forward to hearing from you. ♦

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