Chapter 1
Introduction to Business Combinations and the Conceptual Framework

Multiple Choice

1. Stock given as consideration for a business combination is valued at
   a. fair market value
   b. par value
   c. historical cost
   d. None of the above

2. Which of the following situations best describes a business combination to be accounted for as a statutory merger?
   a. Both companies in a combination continue to operate as separate, but related, legal entities.
   b. Only one of the combining companies survives and the other loses its separate identity.
   c. Two companies combine to form a new third company, and the original two companies are dissolved.
   d. One company transfers assets to another company it has created.

3. A firm can use which method of financing for an acquisition structured as either an asset or stock acquisition?
   a. Cash
   b. Issuing Debt
   c. Issuing Stock
   d. All of the above

4. The objectives of FASB 141R (Business Combinations) and FASB 160 (Noncontrolling Interests in Consolidated Financial Statements) are as follows:
   a. to improve the relevance, comparability, and transparency of financial information related to business combinations.
   b. to eliminate the amortization of Goodwill.
   c. to facilitate the convergence project of the FASB and the International Accounting Standards Board.
   d. a and b only

5. A business combination in which the boards of directors of the potential combining companies negotiate mutually agreeable terms is a(n)
   a. agreeable combination.
   b. friendly combination.
   c. hostile combination.
   d. unfriendly combination.

6. A merger between a supplier and a customer is a(n)
   a. friendly combination.
   b. horizontal combination.
   c. unfriendly combination.
   d. vertical combination.

7. The impairment standard as it relates to goodwill is an example of a
   a. consumption of benefit approach.
   b. loss or lack of benefit approach.
   c. component of other comprehensive income.

   d. direct matching of expenses to revenues.

8. The defense tactic that involves purchasing shares held by the would-be acquiring company at a price substantially in excess of their fair value is called
   a. poison pill.
   b. pac-man defense.
   c. greenmail.
   d. white knight.

9. The third period of business combinations started after World War II and is called
   a. horizontal integration.
   b. merger mania.
   c. operating integration.
   d. vertical integration.

10. Which of the following is **not** a component of other comprehensive income under GAAP?
   a. earnings.
   b. gains and losses that bypass earnings.
   c. impairment losses.
   d. accumulated other comprehensive income.

11. When a new corporation is formed to acquire two or more other corporations and the acquired corporations cease to exist as separate legal entities, the result is a statutory
   a. acquisition.
   b. combination.
   c. consolidation.
   d. merger.

12. The excess of the amount offered in an acquisition over the prior stock price of the acquired firm is the
   a. bonus.
   b. goodwill.
   c. implied offering price.
   d. takeover premium.

13. The difference between normal earnings and expected future earnings is
   a. average earnings.
   b. excess earnings.
   c. ordinary earnings.
   d. target earnings.

14. The first step in estimating goodwill in the excess earnings approach is to
   a. determine normal earnings.
   b. identify a normal rate of return for similar firms.
   c. compute excess earnings.
   d. estimate expected future earnings.

15. Many of FASB's recent pronouncements indicate a shift away from historical cost accounting toward
   a. an elevated status for the *Statements of Financial Accounting Concepts*.
   b. convergence of standards.
   c. fair value accounting.
   d. representationally faithful reporting.

16. Estimated goodwill is determined by computing the present value of the
    a. average earnings.
    b. excess earnings.
    c. expected future earnings.
    d. normal earnings.

17. Which of the following statements would **not** be a valid or logical reason for entering into a business combination?
    a. to increase market share.
    b. to avoid becoming a takeover target.
    c. to reduce risk by acquiring established product lines.
    d. the operating costs of the combined entity would be more than the sum of the separate entities.

18. The parent company concept of consolidation represents the view that the primary purpose of consolidated financial statements is:
    a. to provide information relevant to the controlling stockholders.
    b. to represent the view that the affiliated companies are a separate, identifiable economic entity.
    c. to emphasis control of the whole by a single management.
    d. to include only a portion of the subsidiary's assets, liabilities, revenues, expenses, gains, and losses.

19. Which of the following statements is correct?
    a. Total elimination is consistent with the parent company concept.
    b. Partial elimination is consistent with the economic unit concept.
    c. Past accounting standards required the total elimination of unrealized intercompany profit in assets acquired from affiliated companies.
    d. none of these.

20. Under the parent company concept, consolidated net income ___________ the consolidated net income under the economic unit concept.
    a. is the same as
    b. is higher than
    c. is lower than
    d. can be higher or lower than

21. Under the economic unit concept, noncontrolling interest in net assets is treated as
    a. a liability.
    b. an asset.
    c. stockholders' equity.
    d. an expense.

22. The parent company concept adjusts subsidiary net asset values for the
    a. differences between cost and fair value.
    b. differences between cost and book value.
    c. total fair value implied by the price paid by the parent.
    d. total cost implied by the price paid by the parent.

23. According to the economic unit concept, the primary purpose of consolidated financial statements is to provide information that is relevant to
    a. majority stockholders.
    b. minority stockholders.

c. creditors.
d. both majority and minority stockholders.

24. Which of the following statements is correct?
    a. The economic unit concept suggests partial elimination of unrealized intercompany profits.
    b. The parent company concept suggests partial elimination of unrealized intercompany profits.
    c. The economic unit concept suggests no elimination of unrealized intercompany profits.
    d. The parent company concept suggests total elimination of unrealized intercompany profits.

25. When following the parent company concept in the preparation of consolidated financial statements, noncontrolling interest in combined income is considered a(n)
    a. prorated share of the combined income.
    b. addition to combined income to arrive at consolidated net income.
    c. expense deducted from combined income to arrive at consolidated net income.
    d. deduction from current assets in the balance sheet.

26. When following the economic unit concept in the preparation of consolidated financial statements, the basis for valuing the noncontrolling interest in net assets is the
    a. book values of subsidiary assets and liabilities.
    b. fair values of subsidiary assets and liabilities.
    c. general price level adjusted values of subsidiary assets and liabilities.
    d. fair values of parent company assets and liabilities.

27. The view that consolidated financial statements represent those of a single economic entity with several classes of stockholder interest is consistent with the
    a. parent company concept.
    b. current practice concept.
    c. historical cost company concept.
    d. economic unit concept.

28. The view that the noncontrolling interest in income reflects the noncontrolling stockholders' allocated share of consolidated income is consistent with the
    a. economic unit concept.
    b. parent company concept.
    c. current practice concept.
    d. historical cost company concept.

29. The view that only the parent company's share of the unrealized intercompany profit recognized by the selling affiliate that remains in assets should be eliminated in the preparation of consolidated financial statements is consistent with the
    a. economic unit concept.
    b. current practice concept.
    c. parent company concept.
    d. historical cost company concept.

Problems

1-1 Hopkins Company is considering the acquisition of Richfield, Inc. To assess the amount it might be willing to pay, Hopkins makes the following computations and assumptions.

A. Richfield, Inc. has identifiable assets with a total fair value of $6,000,000 and liabilities of $3,700,000. The assets include office equipment with a fair value approximating book value,

buildings with a fair value 25% higher than book value, and land with a fair value 50% higher than book value. The remaining lives of the assets are deemed to be approximately equal to those used by Richfield, Inc.

B. Richfield, Inc.'s pretax incomes for the years 2011 through 2013 were $470,000, $570,000, and $370,000, respectively. Hopkins believes that an average of these earnings represents a fair estimate of annual earnings for the indefinite future. However, it *may* need to consider adjustments for the following items included in pretax earnings:

Depreciation on Buildings (each year)	380,000
Depreciation on Equipment (each year)	30,000
Extraordinary Loss (year 2013)	130,000
Salary Expense (each year)	170,000

C. The normal rate of return on net assets for the industry is 15%.

Required:

A. Assume that Hopkins feels that it must earn a 20% return on its investment, and that goodwill is determined by capitalizing excess earnings. Based on these assumptions, calculate a reasonable offering price for Richfield, Inc. Indicate how much of the price consists of goodwill.

B. Assume that Hopkins feels that it must earn a 15% return on its investment, but that average excess earnings are to be capitalized for five years only. Based on these assumptions, calculate a reasonable offering price for Richfield, Inc. Indicate how much of the price consists of goodwill.

1-2 Eden Company is trying to decide whether to acquire Bloomington Inc. The following balance sheet for Bloomington Inc. provides information about book values. Estimated market values are also listed, based upon Eden Company's appraisals.

	Bloomington Inc. Book Values	Bloomington Inc. Market Values
Current Assets	$ 450,000	$ 450,000
Property, Plant & Equipment (net)	1,140,000	1,300,000
Total Assets	$1,590,000	$1,750,000
Total Liabilities	$700,000	$700,000
Common Stock, $10 par value	280,000	
Retained Earnings	610,000	
Total Liabilities and Equities	$1,590,000	

Eden Company expects that Bloomington will earn approximately $290,000 per year in net income over the next five years. This income is higher than the 14% annual return on tangible assets considered to be the industry "norm."

Required:

A. Compute an estimation of goodwill based on the information above that Eden might be willing to pay (include in its purchase price), under each of the following additional assumptions:

(1) Eden is willing to pay for *excess* earnings for an expected life of 4 years (undiscounted).

(2) Eden is willing to pay for *excess* earnings for an expected life of 4 years, which should be capitalized at the industry normal rate of return.

(3) Excess earnings are expected to last indefinitely, but Eden demands a higher rate of return of 20% because of the risk involved.

B. Determine the amount of goodwill to be recorded on the books if Eden pays $1,300,000 cash and assumes Bloomington's liabilities.

1-3 Park Company acquired an 80% interest in the common stock of Southdale Company for $1,540,000 on July 1, 2013. Southdale Company's stockholders' equity on that date consisted of:

Common stock	$800,000
Other contributed capital	400,000
Retained earnings	330,000

Required:
Compute the total noncontrolling interest to be reported in the consolidated balance sheet assuming the:

(1) parent company concept.
(2) economic unit concept.

1-4 The following balances were taken from the records of S Company:

Common stock (1/1/13 and 12/31/13)		$720,000
Retained earnings 1/1/13	$160,000	
Net income for 2013	180,000	
Dividends declared in 2013	(40,000)	
Retained earnings, 12/31/13		300,000
Total stockholders' equity on 12/31/13		$1,020,000

P Company purchased 75% of S Company's common stock on January 1, 2011 for $900,000. The difference between implied value and book value is attributable to assets with a remaining useful life on January 1, 2013 of ten years.

Required:

A. Compute the difference between cost/(implied) and book value applying:
   1. Parent company theory.
   2. Economic unit theory.

B. Assuming the economic unit theory:
1. Compute noncontrolling interest in consolidated income for 2013.
2. Compute noncontrolling interest in net assets on December 31, 2013.

Short Answer

1. Estimating the value of goodwill to be included in an offering price can be done under several alternative methods. The excess earnings approach is frequently used. Identify the steps used in this approach to estimate goodwill.

2. The two alternative views of consolidated financial statements are the parent company concept and the economic entity concept. Briefly explain the differences between the concepts.

Short Answer Questions in Textbook
the 'mistakes' with spacing appeared on my printed files, but not here, so I will NOT attempt to make changes

1. Distinguish between internal and external expansion of a firm.

2. List four advantages of a business combination as compared to internal expansion.

3. What is the primary legal constraint on business combinations? Why does such a constraint exist?

4. Business combinations may be classified into three types based upon the relationships among the combining entities (e.g., combinations with suppliers, customers, competitors, etc.). Identify and define these types.

5. Distinguish among a statutory merger, a statutory consolidation, and a stock acquisition.

6. Define a tender offer and describe its use.

7. When stock is exchanged for stock in a business combination, how is the stock exchange ratio generally expressed?

8. Define some defensive measures used by target firms to avoid a takeover. Are these measures beneficial for shareholders?

9. Explain the potential advantages of a stock acquisition over an asset acquisition.

10. Explain the difference between an accretive and a dilutive acquisition.

11. Describe the difference between the economic entity concept and the parent company concept approaches to the reporting of subsidiary assets and liabilities in the consolidated financial statements on the date of the acquisition.

12. Contrast the consolidated effects of the parent company concept and the economic entity con-cept concept in terms of:
    (a)The treatment of noncontrolling interests.
    (b)The elimination of intercompany profits.
    (c)The valuation of subsidiary net assets in the consolidated financial statements.
    (d)The definition of consolidated net income.

13. Under the economic entity concept, the net as-sets assets of the subsidiary are included in the consolidated financial statements at the total fair value that is implied by the price paid by the parent company for its controlling interest. What practical or conceptual problems do you see in this approach to valuation?

14. Is the economic entity or the parent concept more consistent with the principles addressed in the FASB’s conceptual framework? Explain your answer.

15. How does the FASB’s conceptual framework influence the development of new standards?

16. What is the difference between net income, or earnings, and comprehensive income?

Business Ethics Questions from the Textbook

From 1999 to 2001, Tyco's revenue grew approximately24% and it acquired over 700 companies. It was widely rumored that Tyco executives aggressively managed the performance of the companies that they acquired by suggesting that before the acquisition, they should accelerate the payment of liabilities, delay recording the collections of revenue, and increase the estimated amounts in reserve accounts.

1. What effect does each of the three items might list the 3 items as A-B-Chave on the reported net income of the acquired company before the acquisition and on the reported net income of the combined company in the first year of the acquisition and future years?

2. What effect does each of the three items have on the cash from operations of the acquired company before the acquisition and on the cash from operations of the combined company in the first year of the acquisition and future years?

3. If you are the manager of the acquired company, how do you respond to these suggestions?

4. Assume that all three items can be managed within the rules provided by GAAP but would be regarded by many as pushing the limits of GAAP.Is there an ethical issue? Describe your position as: (A) an accountant for the target company and (B) as an accountant for Tyco.

ANSWER KEY

Multiple Choice

1. a	9. b	17. d	25. c
2. b	10. d	18. a	26. b
3. d	11. c	19. c	27. d
4. d	12. d	20. a	28. a
5. b	13. b	21. c	29. c
6. d	14. b	22. b	
7. b	15. c	23. d	
8. c	16. b	24. b	

Problems

1-1

A. Normal earnings for similar firms = ($6,000,000 - $3,700,000) × 15% = $345,000

<u>Expected earnings of target</u>:			
Pretax income of Richfield, Inc., 2011	$470,000		
Subtract: Additional depreciation on buildings ($380,000 × .25)	<u>(95,000</u>)		
Target's adjusted earnings, 2011		375,000	
Pretax income of Richfield, Inc., 2012	$570,000		
Subtract: Additional depreciation on buildings	<u>(95,000</u>)		
Target's adjusted earnings, 2012		475,000	
Pretax income of Richfield, Inc., 2013	$370,000		
Add: Extraordinary loss	130,000		
Subtract: Additional depreciation on buildings	<u>(95,000)</u>		
Target's adjusted earnings, 2013		<u>405,000</u>	
Target's three year total adjusted earnings			1,255,000
Target's three year average adjusted earnings			418,333

Excess earnings of target = $418,333 – $345,000 = $73,333 per year

Present value of excess earnings (perpetuity) at 20%: $\frac{\$73{,}333}{20\%}$ = $366,665 (Estimated Goodwill)

Implied offering price = $6,000,000 - $3,700,000 + $366,665 = 2,666,665.

B. Excess earnings of target (same as in A): $73,333

Present value of excess earnings (ordinary annuity) for five years at 15%; $73,333 × 3.35216 = $245,824

Implied offering price = $6,000,000 - $3,700,000 + $245,824 = $2,545,824.

Note: The salary expense and depreciation on equipment are expected to continue at the same rate, and thus do not necessitate adjustments.

1-2

A. Normal earnings for similar firms (based on tangible assets only) = $1,750,000 × 14% = $245,000

Excess earnings = $290,000 - 245,000 = $45,000

(1) Goodwill based on four years excess earnings undiscounted.
Goodwill = ($45,000)(4 years) = $180,000

(2) Goodwill based on four years discounted excess earnings
Goodwill = ($45,000)(2.91371) = $131,117
(present value of an annuity factor for n=4, I=14% is 2.91371)

(3) Goodwill based on a perpetuity
Goodwill = ($45,000)/.20 = $225,000

B. Goodwill = Cost less fair value of net assets
Goodwill = ($1,300,000 - ($1,750,000 - $700,000)) = $250,000

1-3

1.

Total book value of Southdale's net assets ($800,000 + $400,000 + $330,000)	$1,530,000
Noncontrolling interest %	× .2
Noncontrolling interest in net assets	$306,000

2.

Total fair value of Southdale's net assets ($1,540,000/.8)	$1,925,000
Noncontrolling interest %	× .2
Noncontrolling interest in net assets	$385,000

1-4

A1. Cost of investment	$900,000
Equity acquired .75($720,000 + $160,000)	660,000
Difference (parent company theory)	$240,000
2. Implied value of S Company ($900,000/.75)	$1,200,000
Book value of S Company ($720,000 + $160,000)	880,000
Difference (economic unit theory)	$320,000
B1. Noncontrolling interest in consolidated income: .25[$180,000 - ($320,000/10)]	$37,000
2. Noncontrolling interest in net assets: .25[$1,020,000 + (9/10 × $320,000)]	$327,000

Short Answer

1. The excess earnings approach to estimating goodwill includes the following steps:
   a. Identify a normal rate of return for firms similar to the company being targeted,
   b. Apply the identified rate of return of the level of identifiable assets (or net assets) of the target to approximate what would be normal earnings in this industry,
   c. Estimate the expected future earnings of the target,
   d. Subtract the normal earnings from the expected target earnings to compute "excess earnings",
   e. Assume an appropriate time period and a discount rate to compute the discounted value of the excess earnings − the estimated goodwill.

2. Under the parent company concept, the consolidated financial statements reflect the stockholders' interests in the parent, plus their undivided interests in the net assets of the parent's subsidiaries. The focus is on the interests of the parent's shareholders.

   Under the economic entity concept, control of the whole by a single management is emphasized. With this concept, consolidated financial statements are intended to provide information about a group of legal entities − a parent company and its subsidiaries − operating as a single unit.

Short Answer Questions from the Textbook Solutions

1. Internal expansion involves a normal increase in business resulting from increased demand for products and services, achieved without acquisition of preexisting firms. Some companies expand internally by undertaking new product research to expand their total market, or by attempting to obtain a greater share of a given market through advertising and other promotional activities. Marketing can also be expanded into new geographical areas.

   External expansion is the bringing together of two or more firms under common control by acquisition. Referred to as business combinations, these combined operations may be integrated, or each firm may be left to operate intact.

2. Four advantages of business combinations as compared to internal expansion are:
   (1) Management is provided with an established operating unit with its own experienced personnel, regular suppliers, productive facilities and distribution channels.
   (2) Expanding by combination does not create new competition.
   (3) Permits rapid diversification into new markets.
   (4) Income tax benefits.

3. The primary legal constraint on business combinations is that of possible antitrust suits. The United States government is opposed to the concentration of economic power that may result from business combinations and has enacted two federal statutes, the Sherman Act and the Clayton Act to deal with antitrust problems.

4. (1) A horizontal combination involves companies within the same industry that have previously been competitors.
   (2) Vertical combinations involve a company and its suppliers and/or customers.
   (3) Conglomerate combinations involve companies in unrelated industries having little production or market similarities.

5. A statutory merger results when one company acquires all of the net assets of one or more other companies through an exchange of stock, payment of cash or property, or the issue of debt instruments. The acquiring company remains as the only legal entity, and the acquired company ceases to exist or remains as a separate division of the acquiring company.

   A statutory consolidation results when a new corporation is formed to acquire two or more corporations, through an exchange of voting stock, with the acquired corporations ceasing to exist as separate legal entities.

   A stock acquisition occurs when one corporation issues stock or debt or pays cash for all or part of the voting stock of another company. The stock may be acquired through market purchases or through direct purchase from or exchange with individual stockholders of the investee or subsidiary company.

6. A tender offer is an open offer to purchase up to a stated number of shares of a given corporation at a stipulated price per share. The offering price is generally set above the current market price of the shares to offer an additional incentive to the prospective sellers.

7. A stock exchange ratio is generally expressed as the number of shares of the acquiring company that are to be exchanged for each share of the acquired company.

8. Defensive tactics include:
   (1) Poison pill – when stock rights are issued to existing stockholders that enable them to purchase additional shares at a price below market value, but exercisable only in the event of a potential takeover. This tactic is effective in some cases.
   (2) Greenmail – when the shares held by a would-be acquiring firm are purchased at an amount substantially in excess of their fair value. The shares are then usually held in treasury. This tactic is generally ineffective.
   (3) White knight or white squire – when a third firm more acceptable to the target company management is encouraged to acquire or merge with the target firm.
   (4) Pac-man defense – when the target firm attempts an unfriendly takeover of the would-be acquiring company.
   (5) Selling the crown jewels – when the target firms sells valuable assets to others to make the firm less attractive to an acquirer.

9. In an asset acquisition, the firm must acquire 100% of the assets of the other firm, while in a stock acquisition, a firm may gain control by purchasing 50% or more of the voting stock. Also, in a stock acquisition, formal negotiations with the target's management can sometimes be avoided. Further, in a stock acquisition, there might be advantages in keeping the firms as separate legal entities such as for tax purposes.

10. Does the merger increase or decrease expected earnings performance of the acquiring institution?
    From a financial and shareholder perspective, the price paid for a firm is hard to justify if earnings per share declines. When this happens, the acquisition is considered *dilutive*. Conversely, if the earnings per share increases as a result of the acquisition, it is referred to as an *accretive* acquisition.

11. Under the parent company concept, the writeup or writedown of the net assets of the subsidiary in the consolidated financial statements is restricted to the amount by which the cost of the investment is more or less than the book value of the net assets acquired. Noncontrolling interest in net assets is unaffected by such writeups or writedowns.
    The economic unit concept supports the writeup or writedown of the net assets of the subsidiary by an amount equal to the entire difference between the fair value and the book value of the net assets on the date of acquisition. In this case, noncontrolling interest in consolidated net assets is adjusted for its share of the

writeup or writedown of the net assets of the subsidiary.

12. a) Under the parent company concept, noncontrolling interest is considered a liability of the consolidated entity whereas under the economic unit concept, noncontrolling interest is considered a separate equity interest in consolidated net assets.

    b) The parent company concept supports partial elimination of intercompany profit whereas the economic unit concept supports 100 percent elimination of intercompany profit.

    c) The parent company concept supports valuation of subsidiary net assets in the consolidated financial statements at book value plus an amount equal to the parent company's percentage interest in the difference between fair value and book value. The economic unit concept supports valuation of subsidiary net assets in the consolidated financial statements at their fair value on the date of acquisition without regard to the parent company's percentage ownership interest.

    d) Under the parent company concept, consolidated net income measures the interest of the shareholders of the parent company in the operating results of the consolidated entity. Under the economic unit concept, consolidated net income measures the operating results of the consolidated entity which is then allocated between the controlling and noncontrolling interests.

13. The implied fair value based on the price may not be relevant or reliable since the price paid is a negotiated price which may be impacted by considerations other than or in addition to the fair value of the net assets of the acquired company. There may be practical difficulties in determining the fair value of the consideration given and in allocating the total implied fair value to specific assets and liabilities.

    In the case of a less than wholly owned company, valuation of net assets at implied fair value violates the cost principle of conventional accounting and results in the reporting of subsidiary assets and liabilities using a different valuation procedure than that used to report the assets and liabilities of the parent company.

14. The economic entity is more consistent with the principles addressed in the FASB's conceptual framework. It is an integral part of the FASB's conceptual framework and is named specifically in SFAC No. 5 as one of the basic assumptions in accounting. The economic entity assumption views economic activity as being related to a particular unit of accountability, and the standard indicates that a parent and its subsidiaries represent one economic entity even though they may include several legal entities.

15. The FASB's conceptual framework provides the guidance for new standards. The quality of comparability was very much at stake in FASB's decision in 2001 to eliminate the pooling of interests method for business combinations. This method was also argued to violate the historical cost principle as it essentially ignored the value of the consideration (stock) issued for the acquisition of another company.

    The issue of consistency plays a role in the recent proposal to shift from the parent concept to the economic entity concept, as the former method valued a portion (the noncontrolling interest) of a given asset at prior book values and another portion (the controlling interest) of that same asset at exchange-date market value.

16. Comprehensive income is a broader concept, and it includes some gains and losses explicitly stated by FASB to bypass earnings. The examples of such gains that bypass earnings are some changes in market values of investments, some foreign currency translation adjustments and certain gains and losses, related to minimum pension liability.

    In the absence of gains or losses designated to bypass earnings, earnings and comprehensive income are the same.

ANSWERS TO BUSINESS ETHICS CASE

1. The third item will lead to the reduction of net income of the acquired company before acquisition, and will increase the reported net income of the combined company subsequent to acquisition. The accelerated payment of liabilities should not have an effect on net income in current or future years, nor should the delaying of the collection of revenues (assuming those revenues have already been recorded).

2. The first two items will decrease cash from operations prior to acquisition and will increase cash from operations subsequent to acquisition. The third item will not affect cash from operations.

3. As the manager of the acquired company I would want to make it clear that my future performance (if I stay on with the consolidated company) should not be evaluated based upon a future decline that is perceived rather than real. Further, I would express a concern that shareholders and other users might view such accounting maneuvers as sketchy.

4.
    a) Earnings manipulation is unethical behavior no matter which side of the acquirer/acquiree equation you're on. The rewards that you stand to reap may differ, and thus your risks may vary. But the ethics are essentially the same. Ultimately the company may be one unified whole and the users that are adversely affected by reliance on distorted information may view your participation in an unfavorable light.

    b) See answer to (a).