

1995

Uniform CPA examination. Questions and unofficial answers, 1995 November

American Institute of Certified Public Accountants. Board of Examiners

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Uniform CPA Examination

November 1995

**Questions and
Unofficial Answers**



American Institute of Certified Public Accountants

Uniform CPA Examination

November 1995

**Questions and
Unofficial Answers**

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FOREWORD

The Uniform CPA Examination is prepared by the Board of Examiners of the American Institute of Certified Public Accountants and is used by the examining boards of all fifty states of the United States, the District of Columbia, Puerto Rico, Guam, and the Virgin Islands as a prerequisite for issuance of CPA certificates. This booklet contains the questions and unofficial answers of the November 1995 Uniform Certified Public Accountant Examination.

Although the questions and unofficial answers may be used for many purposes, the principal reason for their publication is to aid candidates in preparing for the examination. Candidates are also encouraged to read *Information for Uniform CPA Examination Candidates*, which describes the content, grading, and other administrative aspects of the Uniform CPA Examination.

The unofficial answers were prepared by the staff of the Examinations Division and reviewed by the Board of Examiners but are not purported to be official positions of the American Institute of Certified Public Accountants. Each of the unofficial answers is accompanied by its maximum point value assigned by the Board of Examiners for grading purposes.

Arleen Rodda Thomas, *Vice President — Self Regulation and SECPS*
American Institute of Certified Public Accountants

November 1995

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E X A M I N A T I O N Q U E S T I O N S

UNIFORM CERTIFIED PUBLIC ACCOUNTANT EXAMINATION Business Law & Professional Responsibilities

The point values for each question, and estimated time allotments based primarily on point value, are as follows:

	Point Value	Estimated Minutes	
		Minimum	Maximum
No. 1	60	90	100
No. 2	10	10	15
No. 3	10	10	15
No. 4	10	15	25
No. 5	10	15	25
Totals	<u>100</u>	<u>140</u>	<u>180</u>

CANDIDATE NUMBER

Record your 7-digit candidate number in the boxes.

Print your **STATE**
name here.

LPR

November 1, 1995; 9:00 A.M. to 12:00 NOON

INSTRUCTIONS TO CANDIDATES *Failure to follow these instructions may have an adverse effect on your Examination grade.*

1. Do not break the seal around *Examination Questions* (pages 3 through 18) until you are told to do so.
2. Question Numbers 1, 2, and 3 should be answered on the *Objective Answer Sheet*, which is pages 27 and 28. You should attempt to answer all objective items. There is no penalty for incorrect responses. Since the objective items are computer-graded, your comments and calculations associated with them are not considered. Be certain that you have entered your answers on the *Objective Answer Sheet* before the examination time is up. The objective portion of your examination will not be graded if you fail to record your answers on the *Objective Answer Sheet*. You will not be given additional time to record your answers.
3. Question Numbers 4 and 5 should be answered beginning on page 19. If you have not completed answering a question on a page, fill in the appropriate spaces in the wording on the bottom of the page "QUESTION NUMBER ____ CONTINUES ON PAGE ____." If you have completed answering a question, fill in the appropriate space in the wording on the bottom of the page "QUESTION NUMBER ____ ENDS ON THIS PAGE." Always begin the start of an answer to a question on the top of a new page (which may be the reverse side of a sheet of paper).
4. Although the primary purpose of the examination is to test your knowledge and application of the subject matter, selected essay responses will be graded for writing skills.
5. You are required to turn in by the end of each session:
 - a. Attendance Record Form, page 1;
 - b. *Examination Questions*, pages 3 through 18;
 - c. *Essay Ruled Paper*, pages 19 through 26;
 - d. *Objective Answer Sheet*, pages 27 and 28; and
 - e. All unused examination materials.

Your examination will not be graded unless the above listed items are handed in before leaving the examination room.
6. Unless otherwise instructed, if you want your *Examination Questions* mailed to you, write your name and address in both places indicated on page 18 and place 55 cents postage in the space provided. *Examination Questions* will be distributed no sooner than the day following the administration of this examination.

Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands of the United States.

Examination Questions Booklet No. _____

Number 1 (Estimated time—90 to 100 minutes)

Select the **best** answer for each of the following items. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of correct answers.

1. According to the ethical standards of the profession, which of the following acts is generally prohibited?

- A. Purchasing a product from a third party and reselling it to a client.
- B. Writing a financial management newsletter promoted and sold by a publishing company.
- C. Accepting a commission for recommending a product to an audit client.
- D. Accepting engagements obtained through the efforts of third parties.

2. According to the ethical standards of the profession, which of the following acts is generally prohibited?

- A. Issuing a modified report explaining a failure to follow a governmental regulatory agency's standards when conducting an attest service for a client.
- B. Revealing confidential client information during a quality review of a professional practice by a team from the state CPA society.
- C. Accepting a contingent fee for representing a client in an examination of the client's federal tax return by an IRS agent.
- D. Retaining client records after an engagement is terminated prior to completion and the client has demanded their return.

3. According to the standards of the profession, which of the following activities may be required in exercising due care?

	<i>Consulting with experts</i>	<i>Obtaining specialty accreditation</i>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

4. According to the standards of the profession, which of the following activities would most likely **not** impair a CPA's independence?

- A. Providing extensive advisory services for a client.
- B. Contracting with a client to supervise the client's office personnel.
- C. Signing a client's checks in emergency situations.
- D. Accepting a luxurious gift from a client.

5. Under the Statements on Standards for Consulting Services, which of the following statements best reflects a CPA's responsibility when undertaking a consulting services engagement? The CPA must

- A. Not seek to modify any agreement made with the client.
- B. Not perform any attest services for the client.
- C. Inform the client of significant reservations concerning the benefits of the engagement.
- D. Obtain a written understanding with the client concerning the time for completion of the engagement.

6. According to the standards of the profession, which of the following sources of information should a CPA consider before signing a client's tax return?

- I. Information actually known to the CPA from the tax return of another client.
- II. Information provided by the client that appears to be correct based on the client's returns from prior years.

- A. I only.
- B. II only.
- C. Both I and II.
- D. Neither I nor II.

Business Law & Professional Responsibilities

7. According to the standards of the profession, which of the following statements is(are) correct regarding the action to be taken by a CPA who discovers an error in a client's previously filed tax return?

- I. Advise the client of the error and recommend the measures to be taken.
 - II. Withdraw from the professional relationship regardless of whether or not the client corrects the error.
- A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

8. Under the "Ultramares" rule, to which of the following parties will an accountant be liable for negligence?

	<u>Parties in privity</u>	<u>Foreseen parties</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

9. When performing an audit, a CPA will most likely be considered negligent when the CPA fails to

- A. Detect all of a client's fraudulent activities.
- B. Include a negligence disclaimer in the client engagement letter.
- C. Warn a client of known internal control weaknesses.
- D. Warn a client's customers of embezzlement by the client's employees.

10. Which of the following is the best defense a CPA firm can assert in a suit for common law fraud based on its unqualified opinion on materially false financial statements?

- A. Contributory negligence on the part of the client.
- B. A disclaimer contained in the engagement letter.
- C. Lack of privity.
- D. Lack of scienter.

11. Under the anti-fraud provisions of Section 10(b) of the Securities Exchange Act of 1934, a CPA may be liable if the CPA acted

- A. Negligently.
- B. With independence.
- C. Without due diligence.
- D. Without good faith.

12. Under Section 11 of the Securities Act of 1933, which of the following standards may a CPA use as a defense?

	<u>Generally accepted accounting principles</u>	<u>Generally accepted fraud detection standards</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

13. Ocean and Associates, CPAs, audited the financial statements of Drain Corporation. As a result of Ocean's negligence in conducting the audit, the financial statements included material misstatements. Ocean was unaware of this fact. The financial statements and Ocean's unqualified opinion were included in a registration statement and prospectus for an original public offering of stock by Drain. Sharp purchased shares in the offering. Sharp received a copy of the prospectus prior to the purchase but did not read it. The shares declined in value as a result of the misstatements in Drain's financial statements becoming known. Under which of the following Acts is Sharp most likely to prevail in a lawsuit against Ocean?

	<u>Securities Exchange Act of 1934, Section 10(b), Rule 10b-5</u>	<u>Securities Act of 1933, Section 11</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

14. Which of the following statements is correct regarding a CPA's working papers? The working papers must be

- A. Transferred to another accountant purchasing the CPA's practice even if the client hasn't given permission.
- B. Transferred permanently to the client if demanded.
- C. Turned over to any government agency that requests them.
- D. Turned over pursuant to a valid federal court subpoena.

15. Thorp, CPA, was engaged to audit Ivor Co.'s financial statements. During the audit, Thorp discovered that Ivor's inventory contained stolen goods. Ivor was indicted and Thorp was subpoenaed to testify at the criminal trial. Ivor claimed accountant-client privilege to prevent Thorp from testifying. Which of the following statements is correct regarding Ivor's claim?

- A. Ivor can claim an accountant-client privilege only in states that have enacted a statute creating such a privilege.
- B. Ivor can claim an accountant-client privilege only in federal courts.
- C. The accountant-client privilege can be claimed only in civil suits.
- D. The accountant-client privilege can be claimed only to limit testimony to audit subject matter.

16. Generally, under the Uniform Partnership Act, a partnership has which of the following characteristics?

	<u>Unlimited duration</u>	<u>Obligation for payment of federal income tax</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

17. Which of the following statements is(are) usually correct regarding general partners' liability?

- I. All general partners are jointly and severally liable for partnership torts.
 - II. All general partners are liable only for those partnership obligations they actually authorized.
- A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

18. Which of the following statements is correct regarding the division of profits in a general partnership when the written partnership agreement only provides that losses be divided equally among the partners? Profits are to be divided

- A. Based on the partners' ratio of contribution to the partnership.
- B. Based on the partners' participation in day to day management.
- C. Equally among the partners.
- D. Proportionately among the partners.

19. Which of the following statements best describes the effect of the assignment of an interest in a general partnership?

- A. The assignee becomes a partner.
- B. The assignee is responsible for a proportionate share of past and future partnership debts.
- C. The assignment automatically dissolves the partnership.
- D. The assignment transfers the assignor's interest in partnership profits and surplus.

20. Park and Graham entered into a written partnership agreement to operate a retail store. Their agreement was silent as to the duration of the partnership. Park wishes to dissolve the partnership. Which of the following statements is correct?

- A. Park may dissolve the partnership at any time.
- B. Unless Graham consents to a dissolution, Park must apply to a court and obtain a decree ordering the dissolution.
- C. Park may **not** dissolve the partnership unless Graham consents.
- D. Park may dissolve the partnership only after notice of the proposed dissolution is given to all partnership creditors.

21. Which of the following facts is(are) generally included in a corporation's articles of incorporation?

	<u>Name of registered agent</u>	<u>Number of authorized shares</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

Business Law & Professional Responsibilities

22. Which of the following statements best describes an advantage of the corporate form of doing business?

- A. Day to day management is strictly the responsibility of the directors.
- B. Ownership is contractually restricted and is **not** transferable.
- C. The operation of the business may continue indefinitely.
- D. The business is free from state regulation.

23. To which of the following rights is a stockholder of a public corporation entitled?

- A. The right to have annual dividends declared and paid.
- B. The right to vote for the election of officers.
- C. The right to a reasonable inspection of corporate records.
- D. The right to have the corporation issue a new class of stock.

24. Carr Corp. declared a 7% stock dividend on its common stock. The dividend

- A. Must be registered with the SEC pursuant to the Securities Act of 1933.
- B. Is includable in the gross income of the recipient taxpayers in the year of receipt.
- C. Has **no** effect on Carr's earnings and profits for federal income tax purposes.
- D. Requires a vote of Carr's stockholders.

25. Which of the following statements is a general requirement for the merger of two corporations?

- A. The merger plan must be approved unanimously by the stockholders of both corporations.
- B. The merger plan must be approved unanimously by the boards of both corporations.
- C. The absorbed corporation must amend its articles of incorporation.
- D. The stockholders of both corporations must be given due notice of a special meeting, including a copy or summary of the merger plan.

26. Which of the following statements is(are) correct regarding debtors' rights?

- I. State exemption statutes prevent all of a debtor's personal property from being sold to pay a federal tax lien.
 - II. Federal social security benefits received by a debtor are exempt from garnishment by creditors.
- A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

27. Which of the following liens generally require(s) the lienholder to give notice of legal action before selling the debtor's property to satisfy the debt?

	<u>Mechanic's lien</u>	<u>Artisan's lien</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

28. Which of the following rights does one cosurety generally have against another cosurety?

- A. Exoneration.
- B. Subrogation.
- C. Reimbursement.
- D. Contribution.

29. Which of the following acts always will result in the total release of a compensated surety?

- A. The creditor changes the manner of the principal debtor's payment.
- B. The creditor extends the principal debtor's time to pay.
- C. The principal debtor's obligation is partially released.
- D. The principal debtor's performance is tendered.

30. When a principal debtor defaults and a surety pays the creditor the entire obligation, which of the following remedies gives the surety the best method of collecting from the debtor?

- A. Exoneration.
- B. Contribution.
- C. Subrogation.
- D. Attachment.

31. Under the Federal Insurance Contributions Act (FICA), which of the following acts will cause an employer to be liable for penalties?

	<u>Failure to supply taxpayer identification numbers</u>	<u>Failure to make timely FICA deposits</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

32. Taxes payable under the Federal Unemployment Tax Act (FUTA) are

- A. Calculated as a fixed percentage of all compensation paid to an employee.
- B. Deductible by the employer as a business expense for federal income tax purposes.
- C. Payable by employers for all employees.
- D. Withheld from the wages of all covered employees.

33. Which of the following claims is(are) generally covered under workers' compensation statutes?

	<u>Occupational disease</u>	<u>Employment aggravated pre-existing disease</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

34. Generally, which of the following statements concerning workers' compensation laws is correct?

- A. The amount of damages recoverable is based on comparative negligence.
- B. Employers are strictly liable without regard to whether or **not** they are at fault.
- C. Workers' compensation benefits are **not** available if the employee is negligent.
- D. Workers' compensation awards are payable for life.

35. Under the Age Discrimination in Employment Act, which of the following remedies is(are) available to a covered employee?

	<u>Early retirement</u>	<u>Back pay</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

36. Which of the following Acts prohibit(s) an employer from discriminating among employees based on sex?

	<u>Equal Pay Act</u>	<u>Title VII of the Civil Rights Act</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

37. Under the Fair Labor Standards Act, which of the following pay bases may be used to pay covered, nonexempt employees who earn, on average, the minimum hourly wage?

	<u>Hourly</u>	<u>Weekly</u>	<u>Monthly</u>
A.	Yes	Yes	Yes
B.	Yes	Yes	No
C.	Yes	No	Yes
D.	No	Yes	Yes

38. Under the Fair Labor Standards Act, if a covered, nonexempt employee works consecutive weeks of 45, 42, 38, and 33 hours, how many hours of overtime must be paid to the employee?

- A. 0
- B. 7
- C. 18
- D. 20

Business Law & Professional Responsibilities

39. Under the Employee Retirement Income Security Act of 1974 (ERISA), which of the following areas of private employer pension plans is(are) regulated?

	<u>Employee vesting</u>	<u>Plan funding</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

40. Which of the following employee benefits is(are) exempt from the provisions of the National Labor Relations Act?

	<u>Sick pay</u>	<u>Vacation pay</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

41. Under the Sales Article of the UCC, a firm offer will be created only if the

- A. Offer states the time period during which it will remain open.
- B. Offer is made by a merchant in a signed writing.
- C. Offeree gives some form of consideration.
- D. Offeree is a merchant.

42. Under the Sales Article of the UCC, when a written offer has been made without specifying a means of acceptance but providing that the offer will only remain open for ten days, which of the following statements represent(s) a valid acceptance of the offer?

- I. An acceptance sent by regular mail the day before the ten-day period expires that reaches the offeror on the eleventh day.
 - II. An acceptance faxed the day before the ten-day period expires that reaches the offeror on the eleventh day, due to a malfunction of the offeror's printer.
- A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

43. Under the Sales Article of the UCC, the warranty of title

- A. Provides that the seller cannot disclaim the warranty if the sale is made to a bona fide purchaser for value.
- B. Provides that the seller deliver the goods free from any lien of which the buyer lacked knowledge when the contract was made.
- C. Applies only if it is in writing and signed by the seller.
- D. Applies only if the seller is a merchant.

44. To establish a cause of action based on strict liability in tort for personal injuries that result from the use of a defective product, one of the elements the injured party must prove is that the seller

- A. Was aware of the defect in the product.
- B. Sold the product to the injured party.
- C. Failed to exercise due care.
- ✓ D. Sold the product in a defective condition.

45. Under the Sales Article of the UCC, which of the following factors is most important in determining who bears the risk of loss in a sale of goods contract?

- A. The method of shipping the goods.
- B. The contract's shipping terms.
- C. Title to the goods.
- D. How the goods were lost.

46. Under the Sales Article of the UCC, in an F.O.B. place of shipment contract, the risk of loss passes to the buyer when the goods

- A. Are identified to the contract.
- B. Are placed on the seller's loading dock.
- C. Are delivered to the carrier.
- D. Reach the buyer's loading dock.

47. Under the Sales Article of the UCC, which of the following rights is(are) available to the buyer when a seller commits an anticipatory breach of contract?

	<u>Demand assurance of performance</u>	<u>Cancel the contract</u>	<u>Collect punitive damages</u>
A.	Yes	Yes	Yes
B.	Yes	Yes	No
C.	Yes	No	Yes
D.	No	Yes	Yes

48. Under the Sales Article of the UCC, and unless otherwise agreed to, the seller's obligation to the buyer is to

- A. Deliver the goods to the buyer's place of business.
- B. Hold conforming goods and give the buyer whatever notification is reasonably necessary to enable the buyer to take delivery.
- C. Deliver all goods called for in the contract to a common carrier.
- D. Set aside conforming goods for inspection by the buyer before delivery.

49. Under the Sales Article of the UCC, which of the following statements regarding liquidated damages is(are) correct?

- I. The injured party may collect any amount of liquidated damages provided for in the contract.
 - II. The seller may retain a deposit of up to \$500 when a buyer defaults even if there is no liquidated damages provision in the contract.
- A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

50. Under the Sales Article of the UCC, which of the following rights is available to a seller when a buyer materially breaches a sales contract?

	<u>Right to cancel the contract</u>	<u>Right to recover damages</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

51. Long, Fall, and Pear own a building as joint tenants with the right of survivorship. Long gave Long's interest in the building to Green by executing and delivering a deed to Green. Neither Fall nor Pear consented to this transfer. Fall and Pear subsequently died. After their deaths, Green's interest in the building would consist of

- A. A 1/3 interest as a joint tenant.
- B. A 1/3 interest as a tenant in common.
- C. No interest because Fall and Pear did **not** consent to the transfer.
- D. Total ownership due to the deaths of Fall and Pear.

52. A method of transferring ownership of real property that most likely would be considered an arm's-length transaction is transfer by

- A. Inheritance.
- B. Eminent domain.
- C. Adverse possession.
- D. Sale.

53. Which of the following provisions must be included to have an enforceable written residential lease?

	<u>A description of the leased premises</u>	<u>A due date for the payment of rent</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

54. Which of the following elements must be contained in a valid deed?

	<u>Purchase price</u>	<u>Description of the land</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

Business Law & Professional Responsibilities

55. Rich purchased property from Sklar for \$200,000. Rich obtained a \$150,000 loan from Marsh Bank to finance the purchase, executing a promissory note and a mortgage. By recording the mortgage, Marsh protects its

- A. Rights against Rich under the promissory note.
- B. Rights against the claims of subsequent bona fide purchasers for value.
- C. Priority against a previously filed real estate tax lien on the property.
- D. Priority against all parties having earlier claims to the property.

56. Which of the following factors help determine whether an item of personal property is a fixture?

- I. Degree of the item's attachment to the property.
 - II. Intent of the person who had the item installed.
- A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

57. Which of the following activities is(are) regulated under the Federal Water Pollution Control Act (Clean Water Act)?

	<i>Discharge of heated water by nuclear power plants</i>	<i>Dredging of wetlands</i>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

58. Which of the following methods of obtaining personal property will give the recipient ownership of the property?

	<i>Lease</i>	<i>Finding abandoned property</i>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

59. A common carrier bailee generally would avoid liability for loss of goods entrusted to its care if the goods are

- A. Stolen by an unknown person.
- B. Negligently destroyed by an employee.
- C. Destroyed by the derailment of the train carrying them due to railroad employee negligence.
- D. Improperly packed by the party shipping them.

60. Which of the following statements correctly describes the requirement of insurable interest relating to property insurance? An insurable interest

- A. Must exist when any loss occurs.
- B. Must exist when the policy is issued and when any loss occurs.
- C. Is created only when the property is owned in fee simple.
- D. Is created only when the property is owned by an individual.

Number 2 (Estimated time—10 to 15 minutes)

Question Number 2 consists of two parts. Each part consists of five items. Select the **best** answer for each item. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Answer all items.** Your grade will be based on the total number of correct answers.

a. Items 61 through 65 are based on the following:

Lace Computer Sales Corp. orally contracted with Banks, an independent consultant, for Banks to work part-time as Lace's agent to perform Lace's customers' service calls. Banks, a computer programmer and software designer, was authorized to customize Lace's software to the customers' needs, on a commission basis, but was specifically told not to sell Lace's computers.

On September 15, Banks made a service call on Clear Co. to repair Clear's computer. Banks had previously called on Clear, customized Lace's software for Clear, and collected cash payments for the work performed. During the call, Banks convinced Clear to buy an upgraded Lace computer for a price much lower than Lace would normally charge. Clear had previously purchased computers from other Lace agents and had made substantial cash down payments to the agents. Clear had no knowledge that the price was lower than normal. Banks received a \$1,000 cash down payment and promised to deliver the computer the next week. Banks never turned in the down payment and left town. When Clear called the following week to have the computer delivered, Lace refused to honor Clear's order.

Required:

Items 61 through 65 relate to the relationships between the parties. For each item, select from List I whether only statement I is correct, whether only statement II is correct, whether both statements I and II are correct, or whether neither statement I nor II is correct. Blacken the corresponding oval on the *Objective Answer Sheet*.

<i>List I</i>	
Ⓐ	I only.
Ⓑ	II only.
Ⓒ	Both I and II.
Ⓓ	Neither I nor II.

- 61. I. Lace's agreement with Banks had to be in writing for it to be a valid agency agreement.
II. Lace's agreement with Banks empowered Banks to act as Lace's agent.
- 62. I. Clear was entitled to rely on Banks' implied authority to customize Lace's software.
II. Clear was entitled to rely on Banks' express authority when buying the computer.
- 63. I. Lace's agreement with Banks was automatically terminated by Banks' sale of the computer.
II. Lace must notify Clear before Banks' apparent authority to bind Lace will cease.
- 64. I. Lace is **not** bound by the agreement made by Banks with Clear.
II. Lace may unilaterally amend the agreement made by Banks to prevent a loss on the sale of the computer to Clear.
- 65. I. Lace, as a disclosed principal, is solely contractually liable to Clear.
II. Both Lace and Banks are contractually liable to Clear.

Number 2 (continued)

b. Items 66 through 70 are based on the following:

Under the provisions of Glenn's testamentary trust, after payment of all administrative expenses and taxes, the entire residuary estate was to be paid to Strong and Lake as trustees. The trustees were authorized to invest the trust assets, and directed to distribute income annually to Glenn's children for their lives, then distribute the principal to Glenn's grandchildren, per capita. The trustees were also authorized to make such principal payments to the income beneficiaries that the trustees determined to be reasonable for the beneficiaries' welfare. Glenn died in 1992. On Glenn's death there were two surviving children, aged 21 and 30, and one two-year-old grandchild.

On June 15, 1995, the trustees made the following distributions from the trust:

- Paid the 1992, 1993, and 1994 trust income to Glenn's children. This amount included the proceeds from the sale of stock received by the trust as a stock dividend.
- Made a \$10,000 principal payment for medical school tuition to one of Glenn's children.
- Made a \$5,000 principal payment to Glenn's grandchild.

Required:

Items 66 through 70 relate to the above fact pattern. For each item, select from List II whether only statement I is correct, whether only statement II is correct, whether both statements I and II are correct, or whether neither statement I nor II is correct. Blacken the corresponding oval on the *Objective Answer Sheet*.

<i>List II</i>	
Ⓐ	I only.
Ⓑ	II only.
Ⓒ	Both I and II.
Ⓓ	Neither I nor II.

- 66. I. Glenn's trust was valid because it did **not** violate the rule against perpetuities.
II. Glenn's trust was valid even though it permitted the trustees to make principal payments to income beneficiaries.
- 67. I. Glenn's trust would be terminated if both of Glenn's children were to die.
II. Glenn's trust would be terminated because of the acts of the trustees.
- 68. I. Strong and Lake violated their fiduciary duties by making any distributions of principal.
II. Strong and Lake violated their fiduciary duties by failing to distribute the trust income annually.
- 69. I. Generally, stock dividends are considered income and should be distributed.
II. Generally, stock dividends should be allocated to principal and remain as part of the trust.
- 70. I. The \$10,000 principal payment was an abuse of the trustees' authority.
II. The \$5,000 principal payment was valid because of its payment to a non-income beneficiary.

Number 3 (Estimated time—10 to 15 minutes)

Question Number 3 consists of two parts. Each part consists of five items. Select the **best** answer for each item. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Answer all items.** Your grade will be based on the total number of correct answers.

a. Items 71 through 75 are based on the following:

On June 1, 1995, Rusk Corp. was petitioned involuntarily into bankruptcy. At the time of the filing, Rusk had the following creditors:

- Safe Bank, for the balance due on the secured note and mortgage on Rusk's warehouse.
- Employee salary claims.
- 1994 federal income taxes due.
- Accountant's fees outstanding.
- Utility bills outstanding.

Prior to the bankruptcy filing, but while insolvent, Rusk engaged in the following transactions:

- On February 1, 1995, Rusk repaid all corporate directors' loans made to the corporation.
- On May 1, 1995, Rusk purchased raw materials for use in its manufacturing business and paid cash to the supplier.

Required:

Items 71 through 75 relate to Rusk's creditors and the February 1 and May 1 transactions. For each item, select from List I whether only statement I is correct, whether only statement II is correct, whether both statements I and II are correct, or whether neither statement I nor II is correct. Blacken the corresponding oval on the *Objective Answer Sheet*.

<i>List I</i>	
Ⓐ	I only.
Ⓑ	II only.
Ⓒ	Both I and II.
Ⓓ	Neither I nor II.

71. I. Safe Bank's claim will be the first paid of the listed claims because Safe is a secured creditor.
II. Safe Bank will receive the entire amount of the balance of the mortgage due as a secured creditor regardless of the amount received from the sale of the warehouse.
72. I. The employee salary claims will be paid in full after the payment of any secured party.
II. The employee salary claims up to \$4,000 per claimant will be paid before payment of any general creditors' claims.
73. I. The claim for 1994 federal income taxes due will be paid as a secured creditor claim.
II. The claim for 1994 federal income taxes due will be paid prior to the general creditor claims.
74. I. The February 1 repayments of the directors' loans were preferential transfers even though the payments were made more than 90 days before the filing of the petition.
II. The February 1 repayments of the directors' loans were preferential transfers because the payments were made to insiders.
75. I. The May 1 purchase and payment was **not** a preferential transfer because it was a transaction in the ordinary course of business.
II. The May 1 purchase and payment was a preferential transfer because it occurred within 90 days of the filing of the petition.

b. Items 76 through 80 are based on the following:

Coffee Corp., a publicly-held corporation, wants to make an \$8,000,000 exempt offering of its shares as a private placement offering under Regulation D, Rule 506, of the Securities Act of 1933. Coffee has more than 500 shareholders and assets in excess of \$1 billion, and has its shares listed on a national securities exchange.

Number 3 (continued)

Required:

Items 76 through 80 relate to the application of the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 to Coffee Corp. and the offering. For each item, select from List II whether only statement I is correct, whether only statement II is correct, whether both statements I and II are correct, or whether neither statement I nor II is correct. Blacken the corresponding oval on the *Objective Answer Sheet*.

<i>List II</i>	
Ⓐ	I only.
Ⓑ	II only.
Ⓒ	Both I and II.
Ⓓ	Neither I nor II.

76. I. Coffee Corp. may make the Regulation D, Rule 506, exempt offering.
 II. Coffee Corp., because it is required to report under the Securities Exchange Act of 1934, may **not** make an exempt offering.
77. I. Shares sold under a Regulation D, Rule 506, exempt offering may only be purchased by accredited investors.
 II. Shares sold under a Regulation D, Rule 506, exempt offering may be purchased by any number of investors provided there are **no** more than 35 non-accredited investors.
78. I. An exempt offering under Regulation D, Rule 506, must **not** be for more than \$10,000,000.
 II. An exempt offering under Regulation D, Rule 506, has **no** dollar limit.
79. I. Regulation D, Rule 506, requires that all investors in the exempt offering be notified that for nine months after the last sale **no** resale may be made to a nonresident.
 II. Regulation D, Rule 506, requires that the issuer exercise reasonable care to assure that purchasers of the exempt offering are buying for investment and are **not** underwriters.

80. I. The SEC must be notified by Coffee Corp. within 5 days of the first sale of the exempt offering securities.
 II. Coffee Corp. must include an SEC notification of the first sale of the exempt offering securities in Coffee's next filed Quarterly Report (Form 10-Q).

Number 4 (Estimated time—15 to 25 minutes)

On July 5, 1995, Korn sent Wilson a written offer to clear Wilson's parking lot whenever it snowed through December 31, 1995. Korn's offer stated that Wilson had until October 1 to accept.

On September 28, 1995, Wilson mailed Korn an acceptance with a request that the agreement continue through March, 1996. Wilson's acceptance was delayed and didn't reach Korn until October 3.

On September 29, 1995, Korn saw weather reports indicating the snowfall for the season would be much heavier than normal. This would substantially increase Korn's costs to perform under the offer.

On September 30, 1995, Korn phoned Wilson to insist that the terms of the agreement be changed. When Wilson refused, Korn orally withdrew the offer and stated that Korn would not perform.

Required:

- a. State and explain the points of law that Korn would argue to show that there was **no** valid contract.
- b. State and explain the points of law that Wilson would argue to show that there was a valid contract.
- c. Assuming that a valid contract existed:
1. Determine whether Korn breached the contract and the nature of the breach and
 2. State the common law remedies available to Wilson.

Number 5 (Estimated time—15 to 25 minutes)

On October 30, 1995, Dover, CPA, was engaged to audit the financial records of Crane Corp., a tractor manufacturer. During the review of notes receivable, Dover reviewed a promissory note given to Crane by Jones Corp., one of its customers, in payment for a tractor. The note appears below.

(Face)

July 18, 1995
Sixty (60) days from date, the undersigned promises to
Pay to the order of <u>Jones Corp.</u>
<u>Twenty Thousand and ⁰⁰/₁₀₀ (\$20,000).....dollars</u>
at West Bank
OVAL CORP.
<u>G.J. Small</u>
By: G.J. Small, Pres.

(Back)

Jones Corp. Without Recourse <u>R. Mall</u> By: R. Mall, Pres.
Crane Corp. For Collection
Payment Refused

On the note's due date, Crane deposited the note for collection and was advised by the bank that Oval had refused payment. After payment was refused, Crane contacted Oval. Oval told Crane that Jones fraudulently induced Oval into executing the note and that Jones knew about Oval's claim before Jones indorsed the note to Crane.

Dover also reviewed a security agreement signed by Harper, a customer, given to Crane to finance Harper's purchase of a tractor for use in Harper's farming business. On October 1, 1995, Harper made a down payment and gave Crane a purchase money security interest for the balance of the price of the tractor. Harper executed a financing statement that was filed on October 10, 1995. The tractor had been delivered to Harper on October 5, 1995. On October 8, 1995, Harper gave Acorn Trust a security agreement covering all of Harper's business equipment, including the tractor. Harper executed a financing statement that Acorn filed on October 9, 1995.

Required:

As the auditor on this engagement, write a memo to the partner-in-charge identifying, explaining, and stating your conclusions about the legal issues pertaining to the note and the security interest.

The memo should address the following:

- Whether Crane is a holder in due course
- Whether Oval will be required to pay the note
- Whether Jones is liable to pay the note
- When Crane's security interest was perfected and whether it had priority over Acorn's security interest

E X A M I N A T I O N Q U E S T I O N S

UNIFORM CERTIFIED PUBLIC ACCOUNTANT EXAMINATION

Auditing

CANDIDATE NUMBER

Record your 7-digit candidate number in the boxes.

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Print your **STATE** name here.

AUDIT

November 1, 1995; 1:30 P.M. to 6:00 P.M.

The point values for each question, and estimated time allotments based primarily on point value, are as follows:

	Point Value	Estimated Minutes	
		Minimum	Maximum
No. 1	60	140	150
No. 2	10	15	25
No. 3	10	15	25
No. 4	10	25	35
No. 5	10	25	35
Totals	<u>100</u>	<u>220</u>	<u>270</u>

INSTRUCTIONS TO CANDIDATES *Failure to follow these instructions may have an adverse effect on your Examination grade.*

1. Do not break the seal around *Examination Questions* (pages 3 through 22) until you are told to do so.
2. Question Numbers 1, 2, and 3 should be answered on the *Objective Answer Sheet*, which is pages 31 and 32. You should attempt to answer all objective items. There is no penalty for incorrect responses. Since the objective items are computer-graded, your comments and calculations associated with them are not considered. Be certain that you have entered your answers on the *Objective Answer Sheet* before the examination time is up. The objective portion of your examination will not be graded if you fail to record your answers on the *Objective Answer Sheet*. You will not be given additional time to record your answers.
3. Question Numbers 4 and 5 should be answered beginning on page 23. If you have not completed answering a question on a page, fill in the appropriate spaces in the wording on the bottom of the page "QUESTION NUMBER ___ CONTINUES ON PAGE ___." If you have completed answering a question, fill in the appropriate space in the wording on the bottom of the page "QUESTION NUMBER ___ ENDS ON THIS PAGE." Always begin the start of an answer to a question on the top of a new page (which may be the reverse side of a sheet of paper).
4. Although the primary purpose of the examination is to test your knowledge and application of the subject matter, selected essay responses will be graded for writing skills.
5. You are required to turn in by the end of each session:
 - a. Attendance Record Form, page 1;
 - b. *Examination Questions*, pages 3 through 22;
 - c. *Essay Ruled Paper*, pages 23 through 30;
 - d. *Objective Answer Sheet*, pages 31 and 32; and
 - e. All unused examination materials.

Your examination will not be graded unless the above listed items are handed in before leaving the examination room.
6. Unless otherwise instructed, if you want your *Examination Questions* mailed to you, write your name and address in both places indicated on page 22 and place 55 cents postage in the space provided. *Examination Questions* will be distributed no sooner than the day following the administration of this examination.

Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands of the United States.

Examination Questions Booklet No. _____

Number 1 (Estimated time—140 to 150 minutes)

Select the **best** answer for each of the following items. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of correct answers.

1. In assessing the objectivity of internal auditors, an independent auditor should

- A. Evaluate the quality control program in effect for the internal auditors.
- B. Examine documentary evidence of the work performed by the internal auditors.
- C. Test a sample of the transactions and balances that the internal auditors examined.
- D. Determine the organizational level to which the internal auditors report.

2. In planning an audit, the auditor's knowledge about the design of relevant internal control policies and procedures should be used to

- A. Identify the types of potential misstatements that could occur.
- B. Assess the operational efficiency of the internal control structure.
- C. Determine whether controls have been circumvented by collusion.
- D. Document the assessed level of control risk.

3. Able Co. uses an online sales order processing system to process its sales transactions. Able's sales data are electronically sorted and subjected to edit checks. A direct output of the edit checks most likely would be a

- A. Report of all missing sales invoices.
- B. File of all rejected sales transactions.
- C. Printout of all user code numbers and passwords.
- D. List of all voided shipping documents.

4. Which of the following auditor concerns most likely could be so serious that the auditor concludes that a financial statement audit **cannot** be conducted?

- A. The entity has **no** formal written code of conduct.
- B. The integrity of the entity's management is suspect.
- C. Procedures requiring segregation of duties are subject to management override.
- D. Management fails to modify prescribed controls for changes in conditions.

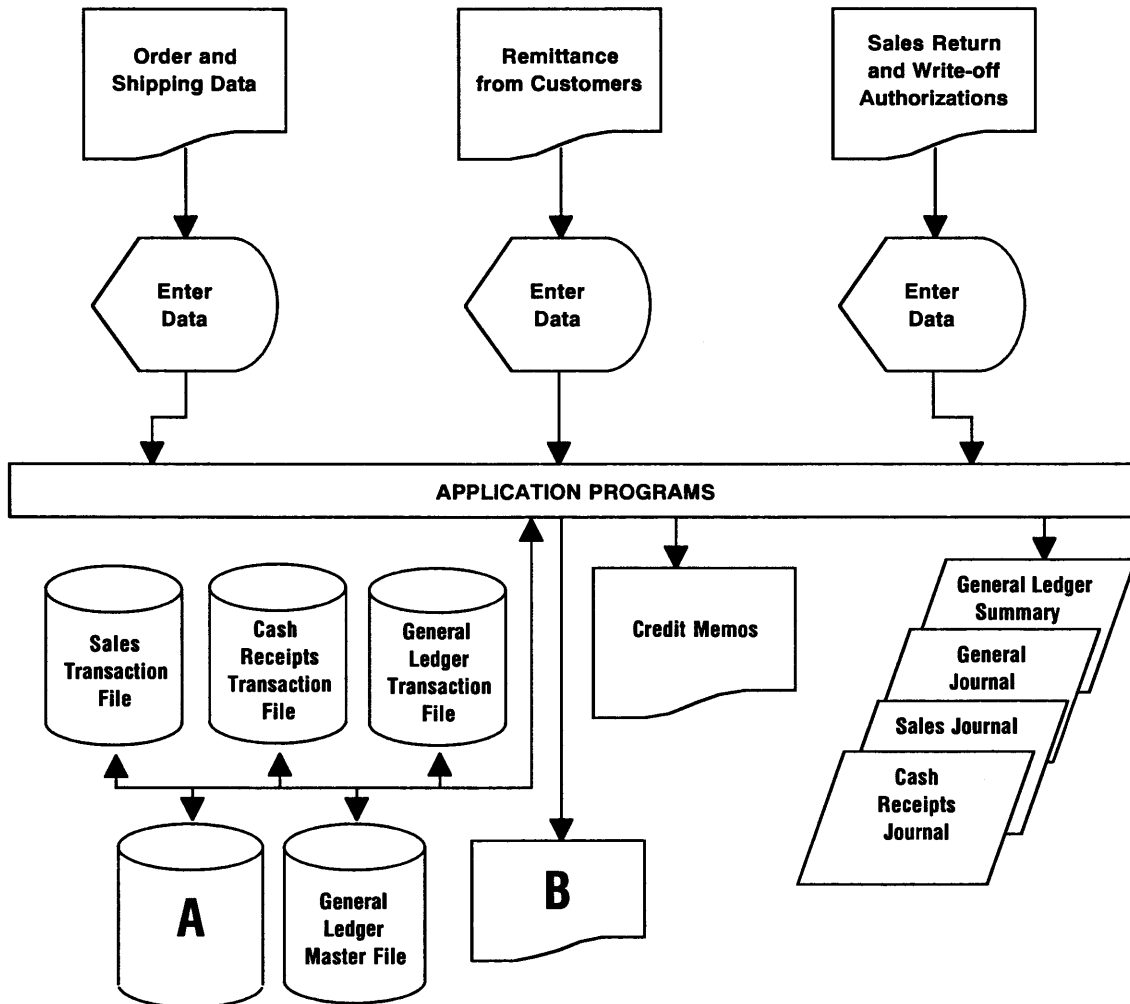
5. Management philosophy and operating style most likely would have a significant influence on an entity's control environment when

- A. The internal auditor reports directly to management.
- B. Management is dominated by one individual.
- C. Accurate management job descriptions delineate specific duties.
- D. The audit committee actively oversees the financial reporting process.

6. Which of the following is a management control method that most likely could improve management's ability to supervise company activities effectively?

- A. Monitoring compliance with internal control requirements imposed by regulatory bodies.
- B. Limiting direct access to assets by physical segregation and protective devices.
- C. Establishing budgets and forecasts to identify variances from expectations.
- D. Supporting employees with the resources necessary to discharge their responsibilities.

Items 7 and 8 are based on the following flowchart of a client's revenue cycle:



7. Symbol A most likely represents
- Remittance advice file.
 - Receiving report file.
 - Accounts receivable master file.
 - Cash disbursements transaction file.

8. Symbol B most likely represents
- Customer orders.
 - Receiving reports.
 - Customer checks.
 - Sales invoices.

9. In an audit of financial statements in accordance with generally accepted auditing standards, an auditor is required to
- Document the auditor's understanding of the entity's internal control structure.
 - Search for significant deficiencies in the operation of the internal control structure.
 - Perform tests of controls to evaluate the effectiveness of the entity's accounting system.
 - Determine whether control procedures are suitably designed to prevent or detect material misstatements.
10. Which of the following is an example of a validity check?
- The computer ensures that a numerical amount in a record does **not** exceed some predetermined amount.
 - As the computer corrects errors and data are successfully resubmitted to the system, the causes of the errors are printed out.
 - The computer flags any transmission for which the control field value did **not** match that of an existing file record.
 - After data for a transaction are entered, the computer sends certain data back to the terminal for comparison with data originally sent.
11. Which of the following types of evidence would an auditor most likely examine to determine whether internal control structure policies and procedures are operating as designed?
- Gross margin information regarding the client's industry.
 - Confirmations of receivables verifying account balances.
 - Client records documenting the use of EDP programs.
 - Anticipated results documented in budgets or forecasts.
12. Which of the following internal controls most likely would reduce the risk of diversion of customer receipts by an entity's employees?
- A bank lockbox system.
 - Prenumbered remittance advices.
 - Monthly bank reconciliations.
 - Daily deposit of cash receipts.
13. In obtaining an understanding of an entity's internal control structure policies and procedures that are relevant to audit planning, an auditor is required to obtain knowledge about the
- Design of the policies and procedures pertaining to the internal control structure elements.
 - Effectiveness of the policies and procedures that have been placed in operation.
 - Consistency with which the policies and procedures are currently being applied.
 - Control procedures related to each principal transaction class and account balance.
14. Which of the following control procedures most likely could prevent EDP personnel from modifying programs to bypass programmed controls?
- Periodic management review of computer utilization reports and systems documentation.
 - Segregation of duties within EDP for computer programming and computer operations.
 - Participation of user department personnel in designing and approving new systems.
 - Physical security of EDP facilities in limiting access to EDP equipment.
15. Which of the following is a control procedure that most likely could help prevent employee payroll fraud?
- The personnel department promptly sends employee termination notices to the payroll supervisor.
 - Employees who distribute payroll checks forward unclaimed payroll checks to the absent employees' supervisors.
 - Salary rates resulting from new hires are approved by the payroll supervisor.
 - Total hours used for determination of gross pay are calculated by the payroll supervisor.

16. Which of the following controls would a company most likely use to safeguard marketable securities when an independent trust agent is **not** employed?

- A. The investment committee of the board of directors periodically reviews the investment decisions delegated to the treasurer.
- B. Two company officials have joint control of marketable securities, which are kept in a bank safe-deposit box.
- C. The internal auditor and the controller independently trace all purchases and sales of marketable securities from the subsidiary ledgers to the general ledger.
- D. The chairman of the board verifies the marketable securities, which are kept in a bank safe-deposit box, each year on the balance sheet date.

17. The diagram below depicts an auditor's estimated maximum deviation rate compared with the tolerable rate, and also depicts the true population deviation rate compared with the tolerable rate.

<i>Auditor's estimate based on sample results</i>	<i>True state of population</i>	
	Deviation rate is less than tolerable rate	Deviation rate exceeds tolerable rate
Maximum deviation rate is less than tolerable rate	I.	III.
Maximum deviation rate exceeds tolerable rate	II.	IV.

As a result of tests of controls, the auditor assesses control risk too low and thereby decreases substantive testing. This is illustrated by situation

- A. I.
- B. II.
- C. III.
- D. IV.

18. In assessing control risk, an auditor ordinarily selects from a variety of techniques, including

- A. Inquiry and analytical procedures.
- B. Reperformance and observation.
- C. Comparison and confirmation.
- D. Inspection and verification.

19. The risk of incorrect acceptance and the likelihood of assessing control risk too low relate to the

- A. Allowable risk of tolerable misstatement.
- B. Preliminary estimates of materiality levels.
- C. Efficiency of the audit.
- D. Effectiveness of the audit.

20. Which of the following statements is correct concerning an auditor's assessment of control risk?

- A. Assessing control risk may be performed concurrently during an audit with obtaining an understanding of the entity's internal control structure.
- B. Evidence about the operation of control procedures in prior audits may **not** be considered during the current year's assessment of control risk.
- C. The basis for an auditor's conclusions about the assessed level of control risk need **not** be documented unless control risk is assessed at the maximum level.
- D. The lower the assessed level of control risk, the less assurance the evidence must provide that the control procedures are operating effectively.

21. An auditor assesses control risk because it

- A. Is relevant to the auditor's understanding of the control environment.
- B. Provides assurance that the auditor's materiality levels are appropriate.
- C. Indicates to the auditor where inherent risk may be the greatest.
- D. Affects the level of detection risk that the auditor may accept.

22. Assessing control risk at below the maximum level most likely would involve

- A. Performing more extensive substantive tests with larger sample sizes than originally planned.
- B. Reducing inherent risk for most of the assertions relevant to significant account balances.
- C. Changing the timing of substantive tests by omitting interim-date testing and performing the tests at year end.
- D. Identifying specific internal control structure policies and procedures relevant to specific assertions.

23. After assessing control risk at below the maximum level, an auditor desires to seek a further reduction in the assessed level of control risk. At this time, the auditor would consider whether

- A. It would be efficient to obtain an understanding of the entity's accounting system.
- B. The entity's internal control structure policies and procedures have been placed in operation.
- C. The entity's internal control structure policies and procedures pertain to any financial statement assertions.
- D. Additional evidential matter sufficient to support a further reduction is likely to be available.

24. When assessing control risk below the maximum level, an auditor is required to document the auditor's

	<i>Understanding of the entity's control environment</i>	<i>Basis for concluding that control risk is below the maximum level</i>
A.	Yes	No
B.	No	Yes
C.	Yes	Yes
D.	No	No

25. An auditor who uses statistical sampling for attributes in testing internal controls should reduce the planned reliance on a prescribed control when the

- A. Sample rate of deviation plus the allowance for sampling risk equals the tolerable rate.
- B. Sample rate of deviation is less than the expected rate of deviation used in planning the sample.
- C. Tolerable rate less the allowance for sampling risk exceeds the sample rate of deviation.
- D. Sample rate of deviation plus the allowance for sampling risk exceeds the tolerable rate.

26. In addition to evaluating the frequency of deviations in tests of controls, an auditor should also consider certain qualitative aspects of the deviations. The auditor most likely would give broader consideration to the implications of a deviation if it was

- A. The only deviation discovered in the sample.
- B. Identical to a deviation discovered during the prior year's audit.
- C. Caused by an employee's misunderstanding of instructions.
- D. Initially concealed by a forged document.

27. When there are numerous property and equipment transactions during the year, an auditor who plans to assess control risk at a low level usually performs

- A. Tests of controls and extensive tests of property and equipment balances at the end of the year.
- B. Analytical procedures for current year property and equipment transactions.
- C. Tests of controls and limited tests of current year property and equipment transactions.
- D. Analytical procedures for property and equipment balances at the end of the year.

28. An auditor suspects that a client's cashier is misappropriating cash receipts for personal use by lapping customer checks received in the mail. In attempting to uncover this embezzlement scheme, the auditor most likely would compare the

- A. Dates checks are deposited per bank statements with the dates remittance credits are recorded.
- B. Daily cash summaries with the sums of the cash receipts journal entries.
- C. Individual bank deposit slips with the details of the monthly bank statements.
- D. Dates uncollectible accounts are authorized to be written off with the dates the write-offs are actually recorded.

29. In testing controls over cash disbursements, an auditor most likely would determine that the person who signs checks also

- A. Reviews the monthly bank reconciliation.
- B. Returns the checks to accounts payable.
- C. Is denied access to the supporting documents.
- D. Is responsible for mailing the checks.

Auditing

30. For effective internal control, the accounts payable department generally should

- A. Stamp, perforate, or otherwise cancel supporting documentation after payment is mailed.
- B. Ascertain that each requisition is approved as to price, quantity, and quality by an authorized employee.
- C. Obliterate the quantity ordered on the receiving department copy of the purchase order.
- D. Establish the agreement of the vendor's invoice with the receiving report and purchase order.

31. In determining the effectiveness of an entity's policies and procedures relating to the existence or occurrence assertion for payroll transactions, an auditor most likely would inquire about and

- A. Observe the segregation of duties concerning personnel responsibilities and payroll disbursement.
- B. Inspect evidence of accounting for prenumbered payroll checks.
- C. Recompute the payroll deductions for employee fringe benefits.
- D. Verify the preparation of the monthly payroll account bank reconciliation.

32. In obtaining an understanding of a manufacturing entity's internal control structure concerning inventory balances, an auditor most likely would

- A. Analyze the liquidity and turnover ratios of the inventory.
- B. Perform analytical procedures designed to identify cost variances.
- C. Review the entity's descriptions of inventory policies and procedures.
- D. Perform test counts of inventory during the entity's physical count.

33. Which of the following factors is(are) considered in determining the sample size for a test of controls?

	<u>Expected deviation rate</u>	<u>Tolerable deviation rate</u>
A.	Yes	Yes
B.	No	No
C.	No	Yes
D.	Yes	No

34. A weakness in internal control over recording retirements of equipment may cause an auditor to

- A. Inspect certain items of equipment in the plant and trace those items to the accounting records.
- B. Review the subsidiary ledger to ascertain whether depreciation was taken on each item of equipment during the year.
- C. Trace additions to the "other assets" account to search for equipment that is still on hand but **no** longer being used.
- D. Select certain items of equipment from the accounting records and locate them in the plant.

35. An auditor's letter issued on reportable conditions relating to an entity's internal control structure observed during a financial statement audit should

- A. Include a brief description of the tests of controls performed in searching for reportable conditions and material weaknesses.
- B. Indicate that the reportable conditions should be disclosed in the annual report to the entity's shareholders.
- C. Include a paragraph describing management's assertion concerning the effectiveness of the internal control structure.
- D. Indicate that the audit's purpose was to report on the financial statements and **not** to provide assurance on the internal control structure.

36. Brown, CPA, has accepted an engagement to examine and report on Crow Company's written assertion about the effectiveness of Crow's internal control structure. In what form may Crow present its written assertion?

- I. In a separate report that will accompany Brown's report.
 - II. In a representation letter to Brown.
- A. I only.
 - B. II only.
 - C. Either I or II.
 - D. Neither I nor II.

37. Computer Services Company (CSC) processes payroll transactions for schools. Drake, CPA, is engaged to report on CSC's policies and procedures placed in operation as of a specific date. These policies and procedures are relevant to the schools' internal control structure, so Drake's report will be useful in providing the schools' independent auditors with information necessary to plan their audits. Drake's report expressing an opinion on CSC's policies and procedures placed in operation as of a specific date should contain a(an)
- Description of the scope and nature of Drake's procedures.
 - Statement that CSC's management has disclosed to Drake all design deficiencies of which it is aware.
 - Opinion on the operating effectiveness of CSC's policies and procedures.
 - Paragraph indicating the basis for Drake's assessment of control risk.
38. An auditor may achieve audit objectives related to particular assertions by
- Performing analytical procedures.
 - Adhering to a system of quality control.
 - Preparing auditor working papers.
 - Increasing the level of detection risk.
39. The confirmation of customers' accounts receivable rarely provides reliable evidence about the completeness assertion because
- Many customers merely sign and return the confirmation without verifying its details.
 - Recipients usually respond only if they disagree with the information on the request.
 - Customers may **not** be inclined to report understatement errors in their accounts.
 - Auditors typically select many accounts with low recorded balances to be confirmed.
40. Which of the following sets of information does an auditor usually confirm on one form?
- Accounts payable and purchase commitments.
 - Cash in bank and collateral for loans.
 - Inventory on consignment and contingent liabilities.
 - Accounts receivable and accrued interest receivable.
41. An auditor's analytical procedures most likely would be facilitated if the entity
- Segregates obsolete inventory before the physical inventory count.
 - Uses a standard cost system that produces variance reports.
 - Corrects material weaknesses in internal control before the beginning of the audit.
 - Develops its data from sources solely within the entity.
42. To measure how effectively an entity employs its resources, an auditor calculates inventory turnover by dividing average inventory into
- Net sales.
 - Cost of goods sold.
 - Operating income.
 - Gross sales.
43. How would increases in tolerable misstatement and assessed level of control risk affect the sample size in a substantive test of details?
- | | <u>Increase in tolerable
misstatement</u> | <u>Increase in assessed
level of control risk</u> |
|----|---|---|
| A. | Increase sample size | Increase sample size |
| B. | Increase sample size | Decrease sample size |
| C. | Decrease sample size | Increase sample size |
| D. | Decrease sample size | Decrease sample size |
44. An advantage of statistical sampling over nonstatistical sampling is that statistical sampling helps an auditor to
- Eliminate the risk of nonsampling errors.
 - Reduce the level of audit risk and materiality to a relatively low amount.
 - Measure the sufficiency of the evidential matter obtained.
 - Minimize the failure to detect errors and irregularities.

45. The usefulness of the standard bank confirmation request may be limited because the bank employee who completes the form may
- A. Not believe that the bank is obligated to verify confidential information to a third party.
 - B. Sign and return the form without inspecting the accuracy of the client's bank reconciliation.
 - C. Not have access to the client's cutoff bank statement.
 - D. Be unaware of all the financial relationships that the bank has with the client.
46. An auditor most likely would limit substantive audit tests of sales transactions when control risk is assessed as low for the existence or occurrence assertion concerning sales transactions and the auditor has already gathered evidence supporting
- A. Opening and closing inventory balances.
 - B. Cash receipts and accounts receivable.
 - C. Shipping and receiving activities.
 - D. Cutoffs of sales and purchases.
47. Which of the following procedures would an auditor most likely perform in searching for unrecorded liabilities?
- A. Trace a sample of accounts payable entries recorded just before year end to the unmatched receiving report file.
 - B. Compare a sample of purchase orders issued just after year end with the year-end accounts payable trial balance.
 - C. Vouch a sample of cash disbursements recorded just after year end to receiving reports and vendor invoices.
 - D. Scan the cash disbursements entries recorded just before year end for indications of unusual transactions.
48. An auditor traced a sample of purchase orders and the related receiving reports to the purchases journal and the cash disbursements journal. The purpose of this substantive audit procedure most likely was to
- A. Identify unusually large purchases that should be investigated further.
 - B. Verify that cash disbursements were for goods actually received.
 - C. Determine that purchases were properly recorded.
 - D. Test whether payments were for goods actually ordered.
49. Which of the following explanations most likely would satisfy an auditor who questions management about significant debits to the accumulated depreciation accounts?
- A. The estimated remaining useful lives of plant assets were revised upward.
 - B. Plant assets were retired during the year.
 - C. The prior year's depreciation expense was erroneously understated.
 - D. Overhead allocations were revised at year end.
50. Which of the following circumstances most likely would cause an auditor to suspect an employee payroll fraud scheme?
- A. There are significant unexplained variances between standard and actual labor cost.
 - B. Payroll checks are disbursed by the same employee each payday.
 - C. Employee time cards are approved by individual departmental supervisors.
 - D. A separate payroll bank account is maintained on an imprest basis.
51. The objective of tests of details of transactions performed as substantive tests is to
- A. Comply with generally accepted auditing standards.
 - B. Attain assurance about the reliability of the accounting system.
 - C. Detect material misstatements in the financial statements.
 - D. Evaluate whether management's policies and procedures operated effectively.
52. A primary advantage of using generalized audit software packages to audit the financial statements of a client that uses an EDP system is that the auditor may
- A. Access information stored on computer files while having a limited understanding of the client's hardware and software features.
 - B. Consider increasing the use of substantive tests of transactions in place of analytical procedures.
 - C. Substantiate the accuracy of data through self-checking digits and hash totals.
 - D. Reduce the level of required tests of controls to a relatively small amount.

53. The work of internal auditors may affect the independent auditor's
- I. Procedures performed in obtaining an understanding of the internal control structure.
 - II. Procedures performed in assessing the risk of material misstatement.
 - III. Substantive procedures performed in gathering direct evidence.
- A. I and II only.
 - B. I and III only.
 - C. II and III only.
 - D. I, II, and III.
54. Which of the following statements is correct concerning an auditor's use of the work of a specialist?
- A. The auditor need **not** obtain an understanding of the methods and assumptions used by the specialist.
 - B. The auditor may **not** use the work of a specialist in matters material to the fair presentation of the financial statements.
 - C. The reasonableness of the specialist's assumptions and their applications are strictly the auditor's responsibility.
 - D. The work of a specialist who has a contractual relationship with the client may be acceptable under certain circumstances.
55. Which of the following is an audit procedure that an auditor most likely would perform concerning litigation, claims, and assessments?
- A. Request the client's lawyer to evaluate whether the client's pending litigation, claims, and assessments indicate a going concern problem.
 - B. Examine the legal documents in the client's lawyer's possession concerning litigation, claims, and assessments to which the lawyer has devoted substantive attention.
 - C. Discuss with management its policies and procedures adopted for evaluating and accounting for litigation, claims, and assessments.
 - D. Confirm directly with the client's lawyer that all litigation, claims, and assessments have been recorded or disclosed in the financial statements.
56. Which of the following procedures would an auditor most likely perform to obtain evidence about the occurrence of subsequent events?
- A. Confirming a sample of material accounts receivable established after year end.
 - B. Comparing the financial statements being reported on with those of the prior period.
 - C. Investigating personnel changes in the accounting department occurring after year end.
 - D. Inquiring as to whether any unusual adjustments were made after year end.
57. Which of the following matters would an auditor most likely include in a management representation letter?
- A. Communications with the audit committee concerning weaknesses in the internal control structure.
 - B. The completeness and availability of minutes of stockholders' and directors' meetings.
 - C. Plans to acquire or merge with other entities in the subsequent year.
 - D. Management's acknowledgment of its responsibility for the detection of employee fraud.
58. Which of the following auditing procedures most likely would assist an auditor in identifying related party transactions?
- A. Inspecting correspondence with lawyers for evidence of unreported contingent liabilities.
 - B. Vouching accounting records for recurring transactions recorded just after the balance sheet date.
 - C. Reviewing confirmations of loans receivable and payable for indications of guarantees.
 - D. Performing analytical procedures for indications of possible financial difficulties.

59. Cooper, CPA, believes there is substantial doubt about the ability of Zero Corp. to continue as a going concern for a reasonable period of time. In evaluating Zero's plans for dealing with the adverse effects of future conditions and events, Cooper most likely would consider, as a mitigating factor, Zero's plans to

- A. Discuss with lenders the terms of all debt and loan agreements.
- B. Strengthen internal controls over cash disbursements.
- C. Purchase production facilities currently being leased from a related party.
- D. Postpone expenditures for research and development projects.

60. The permanent (continuing) file of an auditor's working papers most likely would include copies of the

- A. Lead schedules.
- B. Attorney's letters.
- C. Bank statements.
- D. Debt agreements.

61. Harris, CPA, has been asked to audit and report on the balance sheet of Fox Co. but not on the statements of income, retained earnings, or cash flows. Harris will have access to all information underlying the basic financial statements. Under these circumstances, Harris may

- A. Not accept the engagement because it would constitute a violation of the profession's ethical standards.
- B. Not accept the engagement because it would be tantamount to rendering a piecemeal opinion.
- C. Accept the engagement because such engagements merely involve limited reporting objectives.
- D. Accept the engagement but should disclaim an opinion because of an inability to apply the procedures considered necessary.

62. Which of the following statements is a basic element of the auditor's standard report?

- A. The disclosures provide reasonable assurance that the financial statements are free of material misstatement.
- B. The auditor evaluated the overall internal control structure.
- C. An audit includes assessing significant estimates made by management.
- D. The financial statements are consistent with those of the prior period.

63. An auditor may **not** issue a qualified opinion when

- A. An accounting principle at variance with GAAP is used.
- B. The auditor lacks independence with respect to the audited entity.
- C. A scope limitation prevents the auditor from completing an important audit procedure.
- D. The auditor's report refers to the work of a specialist.

64. An auditor most likely would express an unqualified opinion and would **not** add explanatory language to the report if the auditor

- A. Wishes to emphasize that the entity had significant transactions with related parties.
- B. Concurs with the entity's change in its method of computing depreciation.
- C. Discovers that supplementary information required by FASB has been omitted.
- D. Believes that there is a remote likelihood of a material loss resulting from an uncertainty.

65. An auditor would express an unqualified opinion with an explanatory paragraph added to the auditor's report for

	<i>An unjustified accounting change</i>	<i>A material weakness in the internal control structure</i>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

66. Under which of the following circumstances would a disclaimer of opinion **not** be appropriate?

- A. The auditor is unable to determine the amounts associated with an employee fraud scheme.
- B. Management does **not** provide reasonable justification for a change in accounting principles.
- C. The client refuses to permit the auditor to confirm certain accounts receivable or apply alternative procedures to verify their balances.
- D. The chief executive officer is unwilling to sign the management representation letter.

67. Digit Co. uses the FIFO method of costing for its international subsidiary's inventory and LIFO for its domestic inventory. Under these circumstances, the auditor's report on Digit's financial statements should express an

- A. Unqualified opinion.
- B. Opinion qualified because of a lack of consistency.
- C. Opinion qualified because of a departure from GAAP.
- D. Adverse opinion.

68. The fourth standard of reporting requires the auditor's report to contain either an expression of opinion regarding the financial statements taken as a whole or an assertion to the effect that an opinion cannot be expressed. The objective of the fourth standard is to prevent

- A. An auditor from expressing different opinions on each of the basic financial statements.
- B. Restrictions on the scope of the audit, whether imposed by the client or by the inability to obtain evidence.
- C. Misinterpretations regarding the degree of responsibility the auditor is assuming.
- D. An auditor from reporting on one basic financial statement and **not** the others.

69. In which of the following circumstances would an auditor **not** express an unqualified opinion?

- A. There has been a material change between periods in accounting principles.
- B. Quarterly financial data required by the SEC has been omitted.
- C. The auditor wishes to emphasize an unusually important subsequent event.
- D. The auditor is unable to obtain audited financial statements of a consolidated investee.

70. An explanatory paragraph following the opinion paragraph of an auditor's report describes an uncertainty as follows:

As discussed in Note X to the financial statements, the Company is a defendant in a lawsuit alleging infringement of certain patent rights and claiming damages. Discovery proceedings are in progress. The ultimate outcome of the litigation cannot presently be determined. Accordingly, no provision for any liability that may result upon adjudication has been made in the accompanying financial statements.

What type of opinion should the auditor express under these circumstances?

- A. Adverse.
- B. Qualified due to a scope limitation.
- C. Qualified due to a GAAP violation.
- D. Unqualified.

71. Which of the following phrases would an auditor most likely include in the auditor's report when expressing a qualified opinion because of inadequate disclosure?

- A. Subject to the departure from generally accepted accounting principles, as described above.
- B. With the foregoing explanation of these omitted disclosures.
- C. Except for the omission of the information discussed in the preceding paragraph.
- D. Does **not** present fairly in all material respects.

72. Kane, CPA, concludes that there is substantial doubt about Lima Co.'s ability to continue as a going concern for a reasonable period of time. If Lima's financial statements adequately disclose its financial difficulties, Kane's auditor's report is required to include an explanatory paragraph that specifically uses the phrase(s)

	<u>"Possible discontinuance of operations"</u>	<u>"Reasonable period of time, not to exceed one year"</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

73. Mead, CPA, had substantial doubt about Tech Co.'s ability to continue as a going concern when reporting on Tech's audited financial statements for the year ended June 30, 1994. That doubt has been removed in 1995. What is Mead's reporting responsibility if Tech is presenting its financial statements for the year ended June 30, 1995, on a comparative basis with those of 1994?

- A. The explanatory paragraph included in the 1994 auditor's report should **not** be repeated.
- B. The explanatory paragraph included in the 1994 auditor's report should be repeated in its entirety.
- C. A different explanatory paragraph describing Mead's reasons for the removal of doubt should be included.
- D. A different explanatory paragraph describing Tech's plans for financial recovery should be included.

74. In the first audit of a new client, an auditor was able to extend auditing procedures to gather sufficient evidence about consistency. Under these circumstances, the auditor should

- A. Not report on the client's income statement.
- B. Not refer to consistency in the auditor's report.
- C. State that the consistency standard does **not** apply.
- D. State that the accounting principles have been applied consistently.

75. When reporting on comparative financial statements, an auditor ordinarily should change the previously issued opinion on the prior-year's financial statements if the

- A. Prior year's financial statements are restated to conform with generally accepted accounting principles.
- B. Auditor is a predecessor auditor who has been requested by a former client to reissue the previously issued report.
- C. Prior year's opinion was unqualified and the opinion on the current year's financial statements is modified due to a lack of consistency.
- D. Prior year's financial statements are restated following a pooling of interests in the current year.

76. Jewel, CPA, audited Infinite Co.'s prior-year financial statements. These statements are presented with those of the current year for comparative purposes without Jewel's auditor's report, which expressed a qualified opinion. In drafting the current year's auditor's report, Crain, CPA, the successor auditor, should

- I. Not name Jewel as the predecessor auditor.
- II. Indicate the type of report issued by Jewel.
- III. Indicate the substantive reasons for Jewel's qualification.
 - A. I only.
 - B. I and II only.
 - C. II and III only.
 - D. I, II, and III.

77. The introductory paragraph of an auditor's report contains the following sentences:

We did not audit the financial statements of EZ Inc., a wholly-owned subsidiary, which statements reflect total assets and revenues constituting 27 percent and 29 percent, respectively, of the related consolidated totals. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for EZ Inc., is based solely on the report of the other auditors.

These sentences

- A. Indicate a division of responsibility.
- B. Assume responsibility for the other auditor.
- C. Require a departure from an unqualified opinion.
- D. Are an improper form of reporting.

78. March, CPA, is engaged by Monday Corp., a client, to audit the financial statements of Wall Corp., a company that is not March's client. Monday expects to present Wall's audited financial statements with March's auditor's report to 1st Federal Bank to obtain financing in Monday's attempt to purchase Wall. In these circumstances, March's auditor's report would usually be addressed to

- A. Monday Corp., the client that engaged March.
- B. Wall Corp., the entity audited by March.
- C. 1st Federal Bank.
- D. Both Monday Corp. and 1st Federal Bank.

79. Financial statements of a nonpublic entity that have been reviewed by an accountant should be accompanied by a report stating that a review

- A. Provides only limited assurance that the financial statements are fairly presented.
- B. Includes examining, on a test basis, information that is the representation of management.
- C. Consists principally of inquiries of company personnel and analytical procedures applied to financial data.
- D. Does **not** contemplate obtaining corroborating evidential matter or applying certain other procedures ordinarily performed during an audit.

80. Financial statements of a nonpublic entity compiled without audit or review by an accountant should be accompanied by a report stating that

- A. The scope of the accountant's procedures has **not** been restricted in testing the financial information that is the representation of management.
- B. The accountant assessed the accounting principles used and significant estimates made by management.
- C. The accountant does **not** express an opinion or any other form of assurance on the financial statements.
- D. A compilation consists principally of inquiries of entity personnel and analytical procedures applied to financial data.

81. A CPA's report on agreed-upon procedures related to management's assertion about an entity's compliance with specified requirements should contain

- A. A statement of limitations on the use of the report.
- B. An opinion about whether management's assertion is fairly stated.
- C. Negative assurance that control risk has **not** been assessed.
- D. An acknowledgement of responsibility for the sufficiency of the procedures.

82. When an accountant examines projected financial statements, the accountant's report should include a separate paragraph that

- A. Describes the limitations on the usefulness of the presentation.
- B. Provides an explanation of the differences between an examination and an audit.
- C. States that the accountant is responsible for events and circumstances up to one year after the report's date.
- D. Disclaims an opinion on whether the assumptions provide a reasonable basis for the projection.

83. Field is an employee of Gold Enterprises. Hardy, CPA, is asked to express an opinion on Field's profit participation in Gold's net income. Hardy may accept this engagement only if

- A. Hardy also audits Gold's complete financial statements.
- B. Gold's financial statements are prepared in conformity with GAAP.
- C. Hardy's report is available for distribution to Gold's other employees.
- D. Field owns controlling interest in Gold.

84. Which of the following statements is correct about an auditor's required communication with an entity's audit committee?

- A. Any matters communicated to the entity's audit committee also are required to be communicated to the entity's management.
- B. The auditor is required to inform the entity's audit committee about significant errors discovered by the auditor and subsequently corrected by management.
- C. Disagreements with management about the application of accounting principles are required to be communicated in writing to the entity's audit committee.
- D. Weaknesses in the internal control structure previously reported to the entity's audit committee are required to be communicated to the audit committee after each subsequent audit until the weaknesses are corrected.

85. Which of the following events occurring after the issuance of an auditor's report most likely would cause the auditor to make further inquiries about the previously issued financial statements?

- A. An uninsured natural disaster occurs that may affect the entity's ability to continue as a going concern.
- B. A contingency is resolved that had been disclosed in the audited financial statements.
- C. New information is discovered concerning undisclosed lease transactions of the audited period.
- D. A subsidiary is sold that accounts for 25% of the entity's consolidated net income.

86. A registration statement filed with the SEC contains the reports of two independent auditors on their audits of financial statements for different periods. The predecessor auditor who audited the prior-period financial statements generally should obtain a letter of representation from the

- A. Successor independent auditor.
- B. Client's audit committee.
- C. Principal underwriter.
- D. Securities and Exchange Commission.

87. An auditor is engaged to report on selected financial data that are included in a client-prepared document containing audited financial statements. Under these circumstances, the report on the selected data should

- A. Be limited to data derived from the audited financial statements.
- B. Be distributed only to senior management and the board of directors.
- C. State that the presentation is a comprehensive basis of accounting other than GAAP.
- D. Indicate that the data are **not** fairly stated in all material respects.

88. In auditing a not-for-profit entity that receives governmental financial assistance, the auditor has a responsibility to

- A. Issue a separate report that describes the expected benefits and related costs of the auditor's suggested changes to the entity's internal control structure.
- B. Assess whether management has identified laws and regulations that have a direct and material effect on the entity's financial statements.
- C. Notify the governmental agency providing the financial assistance that the audit is **not** designed to provide any assurance of detecting errors and irregularities.
- D. Render an opinion concerning the entity's continued eligibility for the governmental financial assistance.

89. In auditing compliance with requirements governing major federal financial assistance programs under the Single Audit Act, the auditor's consideration of materiality differs from materiality under generally accepted auditing standards. Under the Single Audit Act, materiality is

- A. Calculated in relation to the financial statements taken as a whole.
- B. Determined separately for each major federal financial assistance program.
- C. Decided in conjunction with the auditor's risk assessment.
- D. Ignored, because all account balances, regardless of size, are fully tested.

90. Which of the following statements represents a quality control requirement under government auditing standards?

- A. A CPA who conducts government audits is required to undergo an annual external quality control review when an appropriate internal quality control system is **not** in place.
- B. A CPA seeking to enter into a contract to perform an audit should provide the CPA's most recent external quality control review report to the party contracting for the audit.
- C. An external quality control review of a CPA's practice should include a review of the working papers of each government audit performed since the prior external quality control review.
- D. A CPA who conducts government audits may **not** make the CPA's external quality control review report available to the public.

Number 2 (Estimated time—15 to 25 minutes)

Question Number 2 consists of 15 items. Select the **best** answer for each item. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Answer all items.** Your grade will be based on the total number of correct answers.

Required:

Items 91 through 105 represent a series of unrelated statements, questions, excerpts, and comments taken from various parts of an auditor's working paper file. Below the items is a list of the likely sources of the statements, questions, excerpts, and comments. Select, as the best answer for each item, the most likely source. Select only one source for each item. A source may be selected once, more than once, or not at all.

Number 2 (continued)

Statements, Questions, Excerpts, and Comments

- | | |
|--|--|
| <p>91. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.</p> <p>92. In connection with an audit of our financial statements, management has prepared, and furnished to our auditors, a description and evaluation of certain contingencies.</p> <p>93. Provision has been made for any material loss to be sustained in the fulfillment of, or from the inability to fulfill, any sales commitments.</p> <p>94. Fees for our services are based on our regular per diem rates, plus travel and other out-of-pocket expenses.</p> <p>95. The objective of our audit is to express an unqualified opinion on the financial statements, although it is possible that facts or circumstances encountered may preclude us from expressing an unqualified opinion.</p> <p>96. There have been no irregularities involving employees that could have a material effect on the financial statements.</p> <p>97. Are you aware of any facts or circumstances that may indicate a lack of integrity by any member of senior management?</p> <p>98. If a difference of opinion on a practice problem existed between engagement personnel and a specialist or other consultant, was the difference resolved in accordance with firm policy and appropriately documented?</p> <p>99. Although we have not conducted a comprehensive, detailed search of our records, no other deposit or loan accounts have come to our attention except as noted below.</p> <p>100. At the conclusion of our audit, we will request certain written representations from you about the financial statements and related matters.</p> | <p>101. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.</p> <p>102. As discussed in Note 14 to the financial statements, the Company has had numerous dealings with businesses controlled by, and people who are related to, the officers of the Company.</p> <p>103. There were unreasonable delays by management in permitting the commencement of the audit and in providing needed information.</p> <p>104. If this statement is not correct, please write promptly, using the enclosed envelope, and give details of any differences directly to our auditors.</p> <p>105. The Company has suffered recurring losses from operations and has a net capital deficiency that raises substantial doubt about its ability to continue as a going concern.</p> |
|--|--|

<i>List of Sources</i>	
Ⓐ	Partner's engagement review program.
Ⓑ	Communication with predecessor auditor.
Ⓒ	Auditor's engagement letter.
Ⓓ	Management representation letter.
Ⓔ	Standard financial institution confirmation request.
Ⓕ	Auditor's communication with the audit committee.
Ⓖ	Auditor's report.
Ⓗ	Letter for underwriters.
Ⓘ	Audit inquiry letter to legal counsel.
Ⓝ	Accounts receivable confirmation.

Number 3 (Estimated time—15 to 25 minutes)

Question Number 3 consists of 15 items. Select the **best** answer for each item. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Answer all items.** Your grade will be based on the total number of correct answers.

Required:

Items 106 through 120 represent a series of unrelated procedures that an accountant may consider performing in separate engagements to review the financial statements of a nonpublic entity (a review) and to compile the financial statements of a nonpublic entity (a compilation). Select, as the best answer for each item, whether the procedure is required **(R)** or not required **(N)** for both review and compilation engagements. Make two selections for each item.

Procedures

- | | |
|---|---|
| 106. The accountant should establish an understanding with the entity regarding the nature and limitations of the services to be performed. | 114. The accountant should obtain a management representation letter from the entity. |
| 107. The accountant should make inquiries concerning actions taken at the board of directors' meetings. | 115. The accountant should study the relationships of the financial statement elements that would be expected to conform to a predictable pattern. |
| 108. The accountant, as the entity's successor accountant, should communicate with the predecessor accountant to obtain access to the predecessor's working papers. | 116. The accountant should communicate to the entity's senior management illegal employee acts discovered by the accountant that are clearly inconsequential. |
| 109. The accountant should obtain a level of knowledge of the accounting principles and practices of the entity's industry. | 117. The accountant should make inquiries about events subsequent to the date of the financial statements that would have a material effect on the financial statements. |
| 110. The accountant should obtain an understanding of the entity's internal control structure. | 118. The accountant should modify the accountant's report if there is a change in accounting principles that is adequately disclosed. |
| 111. The accountant should perform analytical procedures designed to identify relationships that appear to be unusual. | 119. The accountant should submit a hard copy of the financial statements and accountant's report when the financial statements and accountant's report are submitted on a computer disk. |
| 112. The accountant should make an assessment of control risk. | 120. The accountant should perform specific procedures to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern. |
| 113. The accountant should send a letter of inquiry to the entity's attorney to corroborate the information furnished by management concerning litigation. | |

Number 4 (Estimated time—25 to 35 minutes)

Recently there has been a significant number of highly publicized cases of alleged or actual management fraud involving the misstatement of financial statements. Although most client managements possess unquestioned integrity, a very small number, given sufficient incentive and opportunity, may be predisposed to fraudulently misstate reported financial condition and operating results.

Required:

a. What distinguishes management fraud from a defalcation?

b. What are an auditor's responsibilities under generally accepted auditing standards to detect management fraud?

c. What are the characteristics of management fraud that an auditor should consider to fulfill the auditor's responsibilities under generally accepted auditing standards related to detecting management fraud?

d. Three factors that heighten an auditor's concern about the existence of management fraud include (1) an intended public placement of securities in the near future, (2) management remuneration dependent on operating results, and (3) a weak internal control environment evidenced by lack of concern for basic controls and disregard of the auditor's recommendations.

What other factors should heighten an auditor's concern about the existence of management fraud?

Number 5 (Estimated time—25 to 35 minutes)

Most of an auditor's work in forming an opinion on financial statements consists of obtaining and evaluating evidential matter concerning the financial statement assertions.

Required:

a. What is the definition of "financial statement assertions?"

Do not list the assertions.

b. What is the relationship between audit objectives and financial statement assertions?

c. What should an auditor consider in developing the audit objectives of a particular engagement?

d. What is the relationship between audit objectives and audit procedures?

e. What are an auditor's primary considerations when selecting particular substantive tests to achieve audit objectives?

E X A M I N A T I O N Q U E S T I O N S

UNIFORM CERTIFIED PUBLIC ACCOUNTANT EXAMINATION
*Accounting & Reporting—Taxation, Managerial, and
 Governmental and Not-for-Profit Organizations*

CANDIDATE NUMBER						
Record your 7-digit candidate number in the boxes.						
Print your STATE name here.						

The point values for each question, and estimated time allotments based primarily on point value, are as follows:

	<i>Point Value</i>	<i>Estimated Minutes</i>	
		<i>Minimum</i>	<i>Maximum</i>
No. 1	60	120	130
No. 2	5	5	10
No. 3	20	25	40
No. 4	5	5	10
No. 5	10	15	20
Totals	<u>100</u>	<u>170</u>	<u>210</u>

ARE

November 2, 1995; 8:30 A.M. to 12:00 NOON

INSTRUCTIONS TO CANDIDATES *Failure to follow these instructions may have an adverse effect on your Examination grade.*

1. Do not break the seal around the *Examination Questions* (pages 3 through 26) until you are told to do so.
2. All questions should be answered on the *Objective Answer Sheet*, which is pages 27 and 28. You should attempt to answer all objective items. There is no penalty for incorrect responses. Work space to solve the objective questions is provided in the *Examination Questions* on pages 5 through 19. Since the objective items are computer-graded, your comments and calculations associated with them are not considered. Be certain that you have entered your answers on the *Objective Answer Sheet* before the examination time is up. Your examination will not be graded if you fail to record your answers on the *Objective Answer Sheet*. You will not be given additional time to record your answers.
3. You are required to turn in by the end of each session:
 - a. Attendance Record and Calculator Sign-off Record Form, page 1;
 - b. *Examination Questions*, pages 3 through 26;
 - c. *Objective Answer Sheet*, pages 27 and 28;
 - d. Calculator; and
 - e. All unused examination materials.

Your examination will not be graded unless the above listed items are handed in before leaving the examination room.
4. Unless otherwise instructed, if you want your *Examination Questions* mailed to you, write your name and address in both places indicated on page 26 and place 55 cents postage in the space provided. *Examination Questions* will be distributed no sooner than the day following the administration of this examination.

Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands of the United States.

Examination Questions Booklet No.

5. To turn the calculator on press **CA**. The display will read "0." The calculator automatically turns itself off approximately 8 minutes after the last entry. All data in the calculator will be lost once the calculator is off. We recommend that when you press **=**, you press **CA** before beginning a new calculation. The basic key descriptions are as follows:

- CA** **On and Clear**—Clears the calculator of all entries, including entries in memory, once the calculator is on.
- CCE** **Clear Calculation**—Clears the display.
- 0** ... **9** **Numericals**—Inputs that number.
- .** **Decimal**—Indicates that all numbers to follow are decimals.
- ±** **Change sign**—Changes plus (minus) to minus (plus).
- +** & **-** **Add & Subtract**—Adds the next number entered to, or subtracts the next number entered from, the displayed number.

- ×** & **÷** **Multiply & Divide**—Multiplies or divides the displayed number by the next number entered.
- =** **Equal**—Displays the results of all previously entered operations.
- √** **Square Root**—Calculates the square root of the displayed number. It is unlikely that you will need to use this key during the exam.
- %** **Percentage**—Converts the displayed number to a percentage (i.e., divides it by 100) and completes all previously entered operations. It is unlikely that you will need to use this key during the exam.
- M+** **Memory Add**—Adds the displayed number to the balance in memory.
- M-** **Memory Subtract**—Subtracts the displayed number from the balance in memory.
- RCV** **Recall Memory**—Pressed once, displays the balance in memory. Pressed twice in a row, eliminates the balance in memory but not the displayed number.

If your calculator does not work or malfunctions, a replacement calculator will be available from the proctor.

Number 1 (Estimated time—120 to 130 minutes)

Select the **best** answer for each of the following items. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of correct answers.

Items 1 through 38 are in the areas of federal taxation. The answers should be based on the Internal Revenue Code and Tax Regulations in effect for the tax period specified in the item. If no tax period is specified, use the current Internal Revenue Code and Tax Regulations.

1. In 1994, Starke Corp., an accrual-basis calendar year corporation, reported book income of \$380,000. Included in that amount was \$50,000 municipal bond interest income, \$170,000 for federal income tax expense, and \$2,000 interest expense on the debt incurred to carry the municipal bonds. What amount should Starke's taxable income be as reconciled on Starke's Schedule M-1 of Form 1120, U.S. Corporation Income Tax Return?

- A. \$330,000
- B. \$500,000
- C. \$502,000
- D. \$550,000

2. Lake Corp., an accrual-basis calendar year corporation, had the following 1994 receipts:

1995 advanced rental payments where the lease ends in 1996	\$125,000
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Lease cancellation payment from a 5-year lease tenant	50,000
--	--------

Lake had no restrictions on the use of the advanced rental payments and renders no services. What amount of income should Lake report on its 1994 tax return?

- A. \$0
- B. \$ 50,000
- C. \$125,000
- D. \$175,000

3. A C corporation's net capital losses are
- A. Carried forward indefinitely until fully utilized.
 - B. Carried back 3 years and forward 5 years.
 - C. Deductible in full from the corporation's ordinary income.
 - D. Deductible from the corporation's ordinary income only to the extent of \$3,000.

4. In 1994, Best Corp., an accrual-basis calendar year C corporation, received \$100,000 in dividend income from the common stock that it held in an unrelated domestic corporation. The stock was not debt-financed, and was held for over a year. Best recorded the following information for 1994:

Loss from Best's operations	(\$ 10,000)
Dividends received	<u>100,000</u>
Taxable income (before dividends-received deduction)	<u><u>\$ 90,000</u></u>

Best's dividends-received deduction on its 1994 tax return was

- A. \$100,000
- B. \$ 80,000
- C. \$ 70,000
- D. \$ 63,000

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

5. Data Corp., a calendar year corporation, purchased and placed into service office equipment during November 1994. No other equipment was placed into service during 1994. Under the general MACRS depreciation system, what convention must Data use?

- A. Full-year.
- B. Half-year.
- C. Mid-quarter.
- D. Mid-month.

6. Capital assets include

- A. A corporation's accounts receivable from the sale of its inventory.
- B. Seven-year MACRS property used in a corporation's trade or business.
- C. A manufacturing company's investment in U.S. Treasury bonds.
- D. A corporate real estate developer's unimproved land that is to be subdivided to build homes, which will be sold to customers.

7. Baker Corp., a calendar year C corporation, realized taxable income of \$36,000 from its regular business operations for calendar year 1994. In addition, Baker had the following capital gains and losses during 1994:

Short-term capital gain	\$8,500
Short-term capital loss	(4,000)
Long-term capital gain	1,500
Long-term capital loss	(3,500)

Baker did not realize any other capital gains or losses since it began operations. What is Baker's total taxable income for 1994?

- A. \$46,000
- B. \$42,000
- C. \$40,500
- D. \$38,500

8. In 1994, Cable Corp., a calendar year C corporation, contributed \$80,000 to a qualified charitable organization. Cable's 1994 taxable income before the deduction for charitable contributions was \$820,000 after a \$40,000 dividends-received deduction. Cable also had carryover contributions of \$10,000 from the prior year. In 1994, what amount can Cable deduct as charitable contributions?

- A. \$90,000
- B. \$86,000
- C. \$82,000
- D. \$80,000

9. If a corporation's charitable contributions exceed the limitation for deductibility in a particular year, the excess

- A. Is **not** deductible in any future or prior year.
- B. May be carried back or forward for one year at the corporation's election.
- C. May be carried forward to a maximum of five succeeding years.
- D. May be carried back to the third preceding year.

10. In 1994, Stewart Corp. properly accrued \$5,000 for an income item on the basis of a reasonable estimate. In 1995, after filing its 1994 federal income tax return, Stewart determined that the exact amount was \$6,000. Which of the following statements is correct?

- A. No further inclusion of income is required as the difference is less than 25% of the original amount reported and the estimate had been made in good faith.
- B. The \$1,000 difference is includible in Stewart's 1995 income tax return.
- C. Stewart is required to notify the IRS within 30 days of the determination of the exact amount of the item.
- D. Stewart is required to file an amended return to report the additional \$1,000 of income.

MULTIPLE-CHOICE WORK SPACE—This information will **not** be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

11. The uniform capitalization method must be used by

- I. Manufacturers of tangible personal property.
 - II. Retailers of personal property with \$2 million dollars in average annual gross receipts for the 3 preceding years.
- A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

13. Bank Corp. owns 80% of Shore Corp.'s outstanding capital stock. Shore's capital stock consists of 50,000 shares of common stock issued and outstanding. Shore's 1994 net income was \$140,000. During 1994, Shore declared and paid dividends of \$60,000. In conformity with generally accepted accounting principles, Bank recorded the following entries in 1994:

	<u>Debit</u>	<u>Credit</u>
Investment in Shore Corp. common stock	\$112,000	
Equity in earnings of subsidiary		\$112,000
Cash	48,000	
Investment in Shore Corp. common stock		48,000

In its 1994 consolidated tax return, Bank should report dividend revenue of

- A. \$48,000
- B. \$14,400
- C. \$ 9,600
- D. \$0

12. Kane Corp. is a calendar year domestic personal holding company. Which deduction(s) must Kane make from 1994 taxable income to determine undistributed personal holding company income prior to the dividend-paid deduction?

	<u>Federal income taxes</u>	<u>Net long-term capital gain less related federal income taxes</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

14. Dart Corp., a calendar year domestic C corporation, is not a personal holding company. For purposes of the accumulated earnings tax, Dart has accumulated taxable income for 1994. Which step(s) can Dart take to eliminate or reduce any 1994 accumulated earnings tax?

- I. Demonstrate that the "reasonable needs" of its business require the retention of all or part of the 1994 accumulated taxable income.
 - II. Pay dividends by March 15, 1995.
- A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

15. Eastern Corp., a calendar year corporation, was formed January 3, 1994, and on that date placed five-year property in service. The property was depreciated under the general MACRS system. Eastern did not elect to use the straight-line method. The following information pertains to Eastern:

Eastern's 1994 taxable income	\$300,000
Adjustment for the accelerated depreciation taken on 1994 five-year property	1,000
1994 tax-exempt interest from specified private activity bonds issued after August 7, 1986	5,000

What was Eastern's 1994 alternative minimum taxable income before the adjusted current earnings (ACE) adjustment?

- A. \$306,000
- B. \$305,000
- C. \$304,000
- D. \$301,000

16. A civil fraud penalty can be imposed on a corporation that underpays tax by

- A. Omitting income as a result of inadequate recordkeeping.
- B. Failing to report income it erroneously considered **not** to be part of corporate profits.
- C. Filing an incomplete return with an appended statement, making clear that the return is incomplete.
- D. Maintaining false records and reporting fictitious transactions to minimize corporate tax liability.

17. A corporation may reduce its regular income tax by taking a tax credit for

- A. Dividends-received exclusion.
- B. Foreign income taxes.
- C. State income taxes.
- D. Accelerated depreciation.

18. The accumulated earnings tax can be imposed

- A. On both partnerships and corporations.
- B. On companies that make distributions in excess of accumulated earnings.
- C. On personal holding companies.
- D. Regardless of the number of stockholders in a corporation.

19. The following information pertains to Dahl Corp.:

Accumulated earnings and profits at January 1, 1994	\$120,000
Earnings and profits for the year ended December 31, 1994	160,000
Cash distributions to individual stockholders during 1994	360,000

What is the total amount of distributions taxable as dividend income to Dahl's stockholders in 1994?

- A. \$0
- B. \$160,000
- ✓ C. \$280,000
- D. \$360,000

20. Ridge Corp., a calendar year C corporation, made a nonliquidating cash distribution to its shareholders of \$1,000,000 with respect to its stock. At that time, Ridge's current and accumulated earnings and profits totaled \$750,000 and its total paid-in capital for tax purposes was \$10,000,000. Ridge had no corporate shareholders. Ridge's cash distribution

- I. Was taxable as \$750,000 in ordinary income to its shareholders.
 - II. Reduced its shareholders' adjusted bases in Ridge stock by \$250,000.
- A. I only.
 - B. II only.
 - ✓ C. Both I and II.
 - D. Neither I nor II.

MULTIPLE-CHOICE WORK SPACE—This information will **not** be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

21. Clark and Hunt organized Jet Corp. with authorized voting common stock of \$400,000. Clark contributed \$60,000 cash. Both Clark and Hunt transferred other property in exchange for Jet stock as follows:

	<i>Other property</i>		<i>Percentage of Jet stock acquired</i>
	<i>Adjusted basis</i>	<i>Fair market value</i>	
Clark	\$ 50,000	\$100,000	40%
Hunt	120,000	240,000	60%

What was Clark's basis in Jet stock?

- A. \$0
- B. \$100,000
- C. \$110,000
- D. \$160,000

22. Ace Corp. and Bate Corp. combine in a qualifying reorganization and form Carr Corp., the only surviving corporation. This reorganization is tax-free to the

	<i>Shareholders</i>	<i>Corporation</i>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

23. Bass Corp., a calendar year C corporation, made qualifying 1994 estimated tax deposits based on its actual 1993 tax liability. On March 15, 1995, Bass filed a timely automatic extension request for its 1994 corporate income tax return. Estimated tax deposits and the extension payment totalled \$7,600. This amount was 95% of the total tax shown on Bass' final 1994 corporate income tax return. Bass paid \$400 additional tax on the final 1994 corporate income tax return filed before the extended due date. For the 1994 calendar year, Bass was subject to pay

- I. Interest on the \$400 tax payment made in 1995.
 - II. A tax delinquency penalty.
- A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

24. Edge Corp., a calendar year C corporation, had a net operating loss and zero tax liability for its 1994 tax year. To avoid the penalty for underpayment of estimated taxes, Edge could compute its first quarter 1995 estimated income tax payment using the

	<i>Annualized income method</i>	<i>Preceding year method</i>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

25. A corporation's tax year can be reopened after all statutes of limitations have expired if

- I. The tax return has a 50% nonfraudulent omission from gross income.
- II. The corporation prevails in a determination allowing a deduction in an open tax year that was taken erroneously in a closed tax year.
 - A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

26. A penalty for understated corporate tax liability can be imposed on a tax preparer who fails to

- A. Audit the corporate records.
- B. Examine business operations.
- C. Copy all underlying documents.
- ✓ D. Make reasonable inquiries when taxpayer information appears incorrect.

27. Barker acquired a 50% interest in Kode Partnership by contributing \$20,000 cash and a building with an adjusted basis of \$26,000 and a fair market value of \$42,000. The building was subject to a \$10,000 mortgage which was assumed by Kode. The other partners contributed cash only. The basis of Barker's interest in Kode is

- A. \$36,000
- ✓ B. \$41,000
- C. \$52,000
- D. \$62,000

28. At partnership inception, Black acquires a 50% interest in Decorators Partnership by contributing property with an adjusted basis of \$250,000. Black recognizes a gain if

- I. The fair market value of the contributed property exceeds its adjusted basis.
- II. The property is encumbered by a mortgage with a balance of \$100,000.
 - A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

29. Evan, a 25% partner in Vista Partnership, received a \$20,000 guaranteed payment in 1994 for deductible services rendered to the partnership. Guaranteed payments were not made to any other partner. Vista's 1994 partnership income consisted of:

Net business income before	
guaranteed payments	\$80,000
Net long-term capital gains	10,000

What amount of income should Evan report from Vista Partnership on her 1994 tax return?

- A. \$37,500
- B. \$27,500
- C. \$22,500
- D. \$20,000

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

30. On January 4, 1994, Smith and White contributed \$4,000 and \$6,000 in cash, respectively, and formed the Macro General Partnership. The partnership agreement allocated profits and losses 40% to Smith and 60% to White. In 1994, Macro purchased property from an unrelated seller for \$10,000 cash and a \$40,000 mortgage note that was the general liability of the partnership. Macro's liability

- A. Increases Smith's partnership basis by \$16,000.
- B. Increases Smith's partnership basis by \$20,000.
- C. Increases Smith's partnership basis by \$24,000.
- D. Has **no** effect on Smith's partnership basis.

31. Hart's adjusted basis in Best Partnership was \$9,000 at the time he received the following nonliquidating distributions of partnership property:

Cash	\$ 5,000
Land	
Adjusted basis	7,000
Fair market value	10,000

What was the amount of Hart's basis in the land?

- A. \$0
- B. \$ 4,000
- C. \$ 7,000
- D. \$10,000

32. Stone's basis in Ace Partnership was \$70,000 at the time he received a nonliquidating distribution of partnership capital assets. These capital assets had an adjusted basis of \$65,000 to Ace, and a fair market value of \$83,000. Ace had no unrealized receivables, appreciated inventory, or properties which had been contributed by its partners. What was Stone's recognized gain or loss on the distribution?

- A. \$18,000 ordinary income.
- B. \$13,000 capital gain.
- C. \$ 5,000 capital loss.
- D. \$0.

33. On January 3, 1994, the partners' interests in the capital, profits, and losses of Able Partnership were:

	<u>% of capital, profits and losses</u>
Dean	25%
Poe	30%
Ritt	45%

On February 4, 1994, Poe sold her entire interest to an unrelated party. Dean sold his 25% interest in Able to another unrelated party on December 20, 1994. No other transactions took place in 1994. For tax purposes, which of the following statements is correct with respect to Able?

- A. Able terminated as of February 4, 1994.
- B. Able terminated as of December 20, 1994.
- C. Able terminated as of December 31, 1994.
- D. Able did **not** terminate.

MULTIPLE-CHOICE WORK SPACE—This information will **not** be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

34. Curry's sale of her partnership interest causes a partnership termination. The partnership's business and financial operations are continued by the other members. What is(are) the effect(s) of the termination?

- I. There is a deemed distribution of assets to the remaining partners and the purchaser.
- II. There is a hypothetical recontribution of assets to a new partnership.
 - A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

35. A distribution to an estate's sole beneficiary for the 1994 calendar year equalled \$15,000, the amount currently required to be distributed by the will. The estate's 1994 records were as follows:

Estate income

\$40,000 Taxable interest

Estate disbursements

\$34,000 Expenses attributable to taxable interest

What amount of the distribution was taxable to the beneficiary?

- A. \$40,000
- B. \$15,000
- C. \$ 6,000
- D. \$0

36. Steve and Kay Briar, U.S. citizens, were married for the entire 1994 calendar year. In 1994, Steve gave a \$30,000 cash gift to his sister. The Briars made no other gifts in 1994. They each signed a timely election to treat the \$30,000 gift as made one-half by each spouse. Disregarding the unified credit and estate tax consequences, what amount of the 1994 gift is taxable to the Briars?

- A. \$30,000
- B. \$20,000
- C. \$10,000
- D. \$0

37. The organizational test to qualify a public service charitable entity as tax exempt requires the articles of organization to

- I. Limit the purpose of the entity to the charitable purpose.
- II. State that an information return should be filed annually with the Internal Revenue Service.
 - A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

38. Which of the following activities regularly conducted by a tax exempt organization will result in unrelated business income?

- I. Selling articles made by handicapped persons as part of their rehabilitation, when the organization is involved exclusively in their rehabilitation.
 - II. Operating a grocery store almost fully staffed by emotionally handicapped persons as part of a therapeutic program.
- A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

40. Mien Co. is budgeting sales of 53,000 units of product Nous for October 1995. The manufacture of one unit of Nous requires 4 kilos of chemical Loire. During October 1995, Mien plans to reduce the inventory of Loire by 50,000 kilos and increase the finished goods inventory of Nous by 6,000 units. There is no Nous work-in-process inventory. How many kilos of Loire is Mien budgeting to purchase in October 1995?

- A. 138,000
- B. 162,000
- C. 186,000
- D. 238,000

41. The basic difference between a master budget and a flexible budget is that a master budget is

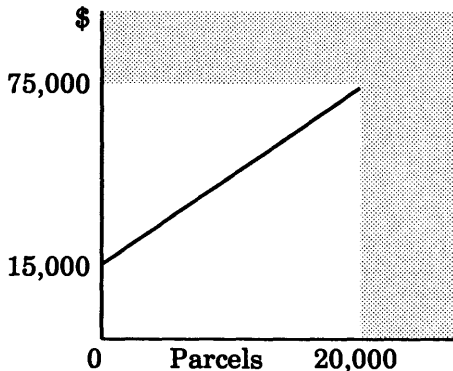
- A. Only used before and during the budget period and a flexible budget is only used after the budget period.
- B. For an entire production facility and a flexible budget is applicable to single departments only.
- C. Based on one specific level of production and a flexible budget can be prepared for any production level within a relevant range.
- D. Based on a fixed standard and a flexible budget allows management latitude in meeting goals.

42. For the next 2 years, a lease is estimated to have an operating net cash inflow of \$7,500 per annum, before adjusting for \$5,000 per annum tax basis lease amortization, and a 40% tax rate. The present value of an ordinary annuity of \$1 per year at 10% for 2 years is \$1.74. What is the lease's after-tax present value using a 10% discount factor?

- A. \$ 2,610
- B. \$ 4,350
- C. \$ 9,570
- D. \$11,310

Items 39 through 56 are in the area of managerial accounting.

39. Sender, Inc. estimates parcel mailing costs using data shown on the chart below.



What is Sender's estimated cost for mailing 12,000 parcels?

- A. \$36,000
- B. \$45,000
- C. \$51,000
- D. \$60,000

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

43. Product Cott has sales of \$200,000, a contribution margin of 20%, and a margin of safety of \$80,000. What is Cott's fixed cost?

- A. \$16,000
- B. \$24,000
- C. \$80,000
- D. \$96,000

44. Break-even analysis assumes that over the relevant range

- A. Unit revenues are nonlinear.
- B. Unit variable costs are unchanged.
- C. Total costs are unchanged.
- D. Total fixed costs are nonlinear.

45. Gram Co. develops computer programs to meet customers' special requirements. How should Gram categorize payments to employees who develop these programs?

	<u>Direct costs</u>	<u>Value-adding costs</u>
A.	Yes	Yes
B.	Yes	No
C.	No	No
D.	No	Yes

46. The Forming Department is the first of a two-stage production process. Spoilage is identified when the units have completed the Forming process. Costs of spoiled units are assigned to units completed and transferred to the second department in the period spoilage is identified. The following information concerns Forming's conversion costs in May 1995:

	<u>Units</u>	<u>Conversion costs</u>
Beginning work-in-process (50% complete)	2,000	\$10,000
Units started during May	8,000	75,500
Spoilage—normal	500	
Units completed & transferred	7,000	
Ending work-in-process (80% complete)	2,500	

Using the weighted average method, what was Forming's conversion cost transferred to the second production department?

- A. \$59,850
- B. \$64,125
- C. \$67,500
- D. \$71,250

47. The standard direct material cost to produce a unit of Lem is 4 meters of material at \$2.50 per meter. During May 1995, 4,200 meters of material costing \$10,080 were purchased and used to produce 1,000 units of Lem. What was the material price variance for May 1995?

- A. \$400 favorable.
- B. \$420 favorable.
- C. \$ 80 unfavorable.
- D. \$480 unfavorable.

MULTIPLE-CHOICE WORK SPACE—This information will **not** be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

48. For purposes of allocating joint costs to joint products, the sales price at point of sale, reduced by cost to complete after split-off, is assumed to be equal to the

- A. Joint costs.
- B. Total costs.
- C. Net sales value at split-off.
- D. Sales price less a normal profit margin at point of sale.

50. The following selected data pertain to the Darwin Division of Beagle Co. for 1994:

Sales	\$400,000
Operating income	40,000
Capital turnover	4
Imputed interest rate	10%

What was Darwin's 1994 residual income?

- A. \$0
- B. \$ 4,000
- C. \$10,000
- D. \$30,000

49. Parat College allocates support department costs to its individual schools using the step method. Information for May 1995 is as follows:

	<u>Support departments</u>	
	<u>Maintenance</u>	<u>Power</u>
Costs incurred	<u>\$99,000</u>	<u>\$54,000</u>
Service percentages provided to:		
Maintenance	—	10%
Power	20%	—
School of Education	30%	20%
School of Technology	<u>50%</u>	<u>70%</u>
	<u>100%</u>	<u>100%</u>

What is the amount of May 1995 support department costs allocated to the School of Education?

- A. \$40,500
- B. \$42,120
- C. \$46,100
- D. \$49,125

51. Key Co. changed from a traditional manufacturing operation with a job order costing system to a just-in-time operation with a back-flush costing system. What is (are) the expected effect(s) of these changes on Key's inspection costs and recording detail of costs tracked to jobs in process?

	<u>Inspection costs</u>	<u>Detail of costs tracked to jobs</u>
A.	Decrease	Decrease
B.	Decrease	Increase
C.	Increase	Decrease
D.	Increase	Increase

52. The economic order quantity formula assumes that

- A. Periodic demand for the good is known.
- B. Carrying costs per unit vary with quantity ordered.
- C. Costs of placing an order vary with quantity ordered.
- D. Purchase costs per unit differ due to quantity discounts.

MULTIPLE-CHOICE WORK SPACE—This information will **not** be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

53. Under frost-free conditions, Cal Cultivators expects its strawberry crop to have a \$60,000 market value. An unprotected crop subject to frost has an expected market value of \$40,000. If Cal protects the strawberries against frost, then the market value of the crop is still expected to be \$60,000 under frost-free conditions and \$90,000 if there is a frost. What must be the probability of a frost for Cal to be indifferent to spending \$10,000 for frost protection?

- A. .167
- B. .200
- C. .250
- D. .333

55. Based on potential sales of 500 units per year, a new product has estimated traceable costs of \$990,000. What is the target price to obtain a 15% profit margin on sales?

- A. \$2,329
- B. \$2,277
- C. \$1,980
- D. \$1,935

54. During 1994, Deet Corp. experienced the following power outages:

<i>Number of outages per month</i>	<i>Number of months</i>
0	3
1	2
2	4
3	3
	<u>12</u>

Each power outage results in out-of-pocket costs of \$400. For \$500 per month, Deet can lease an auxiliary generator to provide power during outages. If Deet leases an auxiliary generator in 1995, the estimated savings (or additional expenditures) for 1995 would be

- A. (\$3,600)
- B. (\$1,200)
- C. \$1,600
- D. \$1,900

56. Lynn Manufacturing Co. prepares income statements using both standard absorption and standard variable costing methods. For 1994, unit standard costs were unchanged from 1993. In 1994, the only beginning and ending inventories were finished goods of 5,000 units. How would Lynn's ratios using absorption costing compare with those using variable costing?

	<i>Current ratio</i>	<i>Return on stockholders' equity</i>
A.	Same	Same
B.	Same	Smaller
C.	Greater	Same
D.	Greater	Smaller

MULTIPLE-CHOICE WORK SPACE—This information will **not** be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

Items 57 through 75 are in the area of accounting for governmental and not-for-profit organizations.

57. Which of the following fund types of a governmental unit has(have) income determination as a measurement focus?

	<i>General funds</i>	<i>Expendable trust funds</i>
A.	Yes	Yes
B.	Yes	No
C.	No	No
D.	No	Yes

58. Fixed assets donated to a governmental unit should be recorded

- A. At the donor's carrying amount.
- B. At estimated fair value when received.
- C. At the lower of the donor's carrying amount or estimated fair value when received.
- D. As a memorandum entry only.

59. Which event(s) is(are) supportive of inter-period equity as a financial reporting objective of a governmental unit?

- I. A balanced budget is adopted.
 - II. Residual equity transfers out equals residual equity transfers in.
- A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

60. Fund accounting is used by governmental units with resources that must be

- A. Composed of cash or cash equivalents.
- B. Incorporated into combined or combining financial statements.
- C. Segregated for the purpose of carrying on specific activities or attaining certain objectives.
- D. Segregated physically according to various objectives.

61. Vale City legally adopts a cash-basis budget. What basis should be used in Vale's combined statement of revenues, expenditures, and changes in fund balances—budget and actual?

- A. Cash.
- B. Modified accrual.
- C. Accrual.
- D. Modified cash.

62. What is the basic criterion used to determine the reporting entity for a governmental unit?

- A. Special financing arrangement.
- B. Geographic boundaries.
- C. Scope of public services.
- D. Financial accountability.

63. Which event(s) should be included in a statement of cash flows for a governmental entity?

- I. Cash inflow from issuing bonds to finance city hall construction.
 - II. Cash outflow from a city utility representing payments in lieu of property taxes.
- A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

64. Fish Road property owners in Sea County are responsible for special assessment debt that arose from a storm sewer project. If the property owners default, Sea has no obligation regarding debt service, although it does bill property owners for assessments and uses the monies it collects to pay debt holders. What fund type should Sea use to account for these collection and servicing activities?

- A. Agency.
- B. Debt service.
- C. Expendable trust funds.
- D. Capital projects.

65. The revenues control account of a governmental unit is increased when

- A. The encumbrance account is decreased.
- B. Appropriations are recorded.
- C. Property taxes are recorded.
- D. The budget is recorded.

66. Tuston Township issued the following bonds during the year ended June 30, 1995:

Bonds issued for the garbage collection enterprise fund that will service the debt	\$700,000
Revenue bonds to be repaid from admission fees collected by the Township zoo enterprise fund	500,000

What amount of these bonds should be accounted for in Tuston's general long-term debt account group?

- A. \$1,200,000
- B. \$ 700,000
- C. \$ 500,000
- D. \$0

67. Frome City signed a 20-year office property lease for its general staff. Frome could terminate the lease at any time after giving one year's notice, but termination is considered a remote possibility. The lease meets the criteria for a capital lease. What is the effect of the lease on the asset amount in Frome's general fixed assets account group and the liability amount in Frome's general long-term debt account group?

	<u>Asset amount</u>	<u>Liability amount</u>
A.	Increase	Increase
B.	Increase	No effect
C.	No effect	Increase
D.	No effect	No effect

68. Polk County's solid waste landfill operation is accounted for in a governmental fund. Polk used available cash to purchase equipment that is included in the estimated current cost of closure and post-closure care of this operation. How would this purchase affect the asset amount in Polk's general fixed assets account group and the liability amount in Polk's general long-term debt account group?

	<u>Asset amount</u>	<u>Liability amount</u>
A.	Increase	Decrease
B.	Increase	No effect
C.	No effect	Decrease
D.	No effect	No effect

69. Financial statements for which fund type generally report retained earnings?

- A. Capital projects.
- B. Enterprise.
- C. Special revenue.
- D. Expendable pension trust.

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

70. Lys City reports a compensated absences liability in its combined balance sheet. The salary rate used to calculate the liability should normally be the rate in effect

- A. When the unpaid compensated absences were earned.
- B. When the compensated absences are to be paid.
- C. At the balance sheet date.
- D. When the compensated absences were earned or are to be paid, or at the balance sheet date, whichever results in the lowest amount.

71. Which account should Spring Township credit when it issues a purchase order for supplies?

- A. Appropriations control.
- B. Vouchers payable.
- C. Encumbrance control.
- D. Reserve for encumbrances.

72. The estimated revenues control account of a governmental unit is debited when

- A. Actual revenues are recorded.
- B. Actual revenues are collected.
- C. The budget is recorded.
- D. The budget is closed at the end of the year.

73. The billings for transportation services provided to other governmental units are recorded by the internal service fund as

- A. Transportation appropriations.
- B. Operating revenues.
- C. Interfund exchanges.
- D. Intergovernmental transfers.

74. A large not-for-profit organization's statement of activities should report the net change for net assets that are

	<u>Unrestricted</u>	<u>Permanently restricted</u>
A.	Yes	Yes
B.	Yes	No
C.	No	No
D.	No	Yes

75. Which of the following should normally be considered ongoing or central transactions for a not-for-profit hospital?

- I. Room and board fees from patients.
 - II. Recovery room fees.
- A. Neither I nor II.
 - B. Both I and II.
 - C. II only.
 - D. I only.

MULTIPLE-CHOICE WORK SPACE—This information will **not** be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

Number 2 (Estimated time—5 to 10 minutes)

Question Number 2 consists of 6 items. Select the **best** answer for each item. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Answer all items.** Your grade will be based on the total number of correct answers.

Lan Corp., an accrual-basis calendar year repair-service corporation, began business on Monday, January 3, 1994. Lan's valid S corporation election took effect retroactively on January 3, 1994.

Required:

a. For **Items 76 through 79**, determine the amount, if any, using the fact pattern for each item. To record your answer, blacken the ovals on the *Objective Answer Sheet*. If zeros precede your numerical answer, blacken the zeros in the ovals preceding your answer. **You cannot receive credit for your answers if you fail to blacken an oval in each column.** You may write the numbers in the boxes provided to facilitate blackening the ovals; however, the numbers written in the boxes will **not** be graded.

76. Assume the following facts:

Lan's 1994 books recorded the following items:

Gross receipts	\$7,260
Interest income on investments	50
Charitable contributions	1,000
Supplies	1,120

What amount of net business income should Lan report on its 1994 Form 1120S, U.S. Income Tax Return for an S Corporation, Schedule K?

77. Assume the following facts:

As of January 3, 1994, Taylor and Barr each owned 100 shares of the 200 issued shares of Lan stock. On January 31, 1994, Taylor and Barr each sold 20 shares to Pike. No election was made to terminate the tax year. Lan had net business income of \$14,520 for the year ended December 31, 1994, and made no distributions to its shareholders. Lan's 1994 calendar year had 363 days.

What amount of net business income should have been reported on Pike's 1994 Schedule K-1 from Lan? (1994 is a 363-day tax year.) Round the answer to the nearest hundred.

78. Assume the following facts:

Pike purchased 40 Lan shares on January 31, 1994, for \$4,000. Lan made no distributions to shareholders, and Pike's 1994 Schedule K-1 from Lan reported:

Ordinary business loss	(\$1,000)
Municipal bond interest income	150

What was Pike's basis in his Lan stock at December 31, 1994?

79. Assume the following facts:

On January 3, 1994, Taylor and Barr each owned 100 shares of the 200 issued shares of Lan stock. Taylor's basis in Lan shares on that date was \$10,000. Taylor sold all of his Lan shares to Pike on January 31, 1994, and Lan made a valid election to terminate its tax year. Taylor's share of ordinary income from Lan prior to the sale was \$2,000. Lan made a cash distribution of \$3,000 to Taylor on January 30, 1994.

What was Taylor's basis in Lan shares for determining gain or loss from the sale to Pike?

Required:

b. For **Items 80 and 81**, indicate if the statement is true (T) or false (F) regarding Lan's S corporation status. Blacken the corresponding oval on the *Objective Answer Sheet*.

80. Lan issues shares of both preferred and common stock to shareholders at inception on January 3, 1994. This will **not** affect Lan's S corporation eligibility.

81. Lan, an S corporation since inception, has passive investment income for 3 consecutive years following the year a valid S corporation election takes effect. Lan's S corporation election is terminated as of the first day of the fourth year.

Number 3 (Estimated time—25 to 40 minutes)

Question Number 3 consists of 29 items. Select the **best** answer for each item. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Answer all items.** Your grade will be based on the total number of correct answers.

Tom and Joan Moore, both CPAs, filed a joint 1994 federal income tax return showing \$70,000 in taxable income. During 1994, Tom's daughter Laura, age 16, resided with Tom's former spouse. Laura had no income of her own and was not Tom's dependent.

Required:

a. For **Items 82 through 91**, determine the amount of income or loss, if any, that should be included on page one of the Moores' 1994 Form 1040. To record your answer, blacken the ovals on the *Objective Answer Sheet*. If zeros precede your numerical answer, blacken the zeros in the ovals preceding your answer. **You cannot receive credit for your answers if you fail to blacken an oval in each column.** You may write the numbers in the boxes provided to facilitate blackening the ovals; however, the numbers written in the boxes will **not** be graded.

82. The Moores had no capital loss carryovers from prior years. During 1994 the Moores had the following stock transactions which resulted in a net capital loss:

	<i>Date acquired</i>	<i>Date sold</i>	<i>Sales price</i>	<i>Cost</i>
Revco	2-1-93	3-17-94	\$15,000	\$25,000
Abcco	2-18-94	4-1-94	8,000	4,000

83. In 1992, Joan received an acre of land as an inter-vivos gift from her grandfather. At the time of the gift, the land had a fair market value of \$50,000. The grandfather's adjusted basis was \$60,000. Joan sold the land in 1994 to an unrelated third party for \$56,000.

84. The Moores received a \$500 security deposit on their rental property in 1994. They are required to return the amount to the tenant.

85. Tom's 1994 wages were \$53,000. In addition, Tom's employer provided group-term life insurance on Tom's life in excess of \$50,000. The value of such excess coverage was \$2,000.

86. During 1994, the Moores received a \$2,500 federal tax refund and a \$1,250 state tax refund for 1993 overpayments. In 1993, the Moores were not subject to the alternative minimum tax and were not entitled to any credit against income tax. The Moores' 1993 adjusted gross income was \$80,000 and itemized deductions were \$1,450 in excess of the standard deduction. The state tax deduction for 1993 was \$2,000.

87. In 1994, Joan received \$1,300 in unemployment compensation benefits. Her employer made a \$100 contribution to the unemployment insurance fund on her behalf.

88. The Moores received \$8,400 in gross receipts from their rental property during 1994. The expenses for the residential rental property were:

Bank mortgage interest	\$1,200
Real estate taxes	700
Insurance	500
MACRS depreciation	3,500

89. The Moores received a stock dividend in 1994 from Ace Corp. They had the option to receive either cash or Ace stock with a fair market value of \$900 as of the date of distribution. The par value of the stock was \$500.

Number 3 (continued)

- 90. In 1994, Joan received \$3,500 as beneficiary of the death benefit which was provided by her brother's employer. Joan's brother did not have a nonforfeitable right to receive the money while living.
- 91. Tom received \$10,000, consisting of \$5,000 each of principal and interest, when he redeemed a Series EE savings bond in 1994. The bond was issued in his name in 1987 and the proceeds were used to pay for Laura's college tuition. Tom had not elected to report the yearly increases in the value of the bond.

Required:

b. For **Item 92**, determine the amount of the adjustment, if any, to arrive at adjusted gross income. To record your answer, blacken the ovals on the *Objective Answer Sheet*. If zeros precede your numerical answer, blacken the zeros in the ovals preceding your answer. **You cannot receive credit for your answers if you fail to blacken an oval in each column.** You may write the numbers in the boxes provided to facilitate blackening the ovals; however, the numbers written in the boxes will **not** be graded.

- 92. As required by a 1990 divorce agreement, Tom paid an annual amount of \$8,000 in alimony and \$10,000 in child support during 1994.

Required:

c. During 1994, the following events took place. For **Items 93 to 104**, select the appropriate tax treatment and blacken the corresponding oval on the *Objective Answer Sheet*. A tax treatment may be selected once, more than once, or not at all.

Event

<ul style="list-style-type: none"> 93. On March 23, 1994, Tom sold 50 shares of Zip stock at a \$1,200 loss. He repurchased 50 shares of Zip on April 15, 1994. 94. Payment of a personal property tax based on the value of the Moores' car. 95. Used clothes were donated to church organizations. 96. Premiums were paid covering insurance against Tom's loss of earnings. 97. Tom paid for subscriptions to accounting journals. 98. Interest was paid on a \$10,000 home-equity line of credit secured by the Moores' residence. The fair market value of the home exceeded the mortgage by \$50,000. Tom used the proceeds to purchase a sailboat. 99. Amounts were paid in excess of insurance reimbursement for prescription drugs. 100. Funeral expenses were paid by the Moores for Joan's brother. 101. Theft loss was incurred on Joan's jewelry in excess of insurance reimbursement. There were no 1994 personal casualty gains. 102. Loss on the sale of the family's sailboat. 	<ul style="list-style-type: none"> 103. Interest was paid on the \$300,000 acquisition mortgage on the Moores' home. The mortgage is secured by their home. 104. Joan performed free accounting services for the Red Cross. The estimated value of the services was \$500.
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<i>Tax Treatment</i>	
Ⓐ	Not deductible on Form 1040.
Ⓑ	Deductible in full in Schedule A-Itemized Deductions.
Ⓒ	Deductible in Schedule A-Itemized Deductions, subject to a threshold of 7.5% of adjusted gross income.
Ⓓ	Deductible in Schedule A-Itemized Deductions, subject to a limitation of 50% of adjusted gross income.
Ⓔ	Deductible in Schedule A-Itemized Deductions, subject to a \$100 floor and a threshold of 10% of adjusted gross income.
Ⓕ	Deductible in Schedule A-Itemized Deductions, subject to a threshold of 2% of adjusted gross income.

Number 3 (continued)

Required:

d. For **Items 105 to 110**, indicate if the statement is true (T) or false (F) regarding the Moores' 1994 tax return. Blacken the corresponding oval on the *Objective Answer Sheet*.

105. For 1994, the Moores were subject to the phaseout of half their personal exemptions for regular tax because their adjusted gross income was \$75,000.
106. The Moores' unreimbursed medical expenses for AMT had to exceed 10% of adjusted gross income.
107. The Moores' personal exemption amount for regular tax was not permitted for determining 1994 AMT.
108. The Moores paid \$1,200 in additional 1994 taxes when they filed their return on Friday, April 14, 1995. Their 1994 federal tax withholdings equalled 100% of 1993 tax liability. Therefore, they were not subject to the underpayment of tax penalty.
109. The Moores, both being under age 50, were subject to an early withdrawal penalty on their IRA withdrawals used for medical expenses.
110. The Moores were allowed an earned income credit against their 1994 tax liability equal to a percentage of their wages.

Number 4 (Estimated time—5 to 10 minutes)

Question Number 4 consists of 6 items. Select the **best** answer for each item. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Answer all items.** Your grade will be based on the total number of correct answers.

Alpha Hospital, a large not-for-profit organization, has adopted an accounting policy that does not imply a time restriction on gifts of long-lived assets.

Required:

For **Items 111 through 116**, indicate, by blackening the corresponding oval on the *Objective Answer Sheet*, the manner in which the transaction affects Alpha's financial statements.

- (A) Increase in unrestricted revenues, gains, and other support.
- (B) Decrease in an expense.
- (C) Increase in temporarily restricted net assets.
- (D) Increase in permanently restricted net assets.
- (E) No required reportable event.
111. Alpha's board designates \$1,000,000 to purchase investments whose income will be used for capital improvements.
112. Income from investments in item 111 above, which was not previously accrued, is received.
113. A benefactor provided funds for building expansion.
114. The funds in item 113 above are used to purchase a building in the fiscal period following the period the funds were received.
115. An accounting firm prepared Alpha's annual financial statements without charge to Alpha.
116. Alpha received investments subject to the donor's requirement that investment income be used to pay for outpatient services.

Number 5 (Estimated time—15 to 20 minutes)

Question Number 5 consists of 10 items. Select the **best** answer for each item. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Answer all items.** Your grade will be based on the total number of correct answers.

The following information relates to Dane City during its fiscal year ended December 31, 1994:

- On October 31, 1994, to finance the construction of a city hall annex, Dane issued 8% 10-year general obligation bonds at their face value of \$600,000. Construction expenditures during the period equaled \$364,000.
- Dane reported \$109,000 from hotel room taxes, restricted for tourist promotion, in a special revenue fund. The fund paid \$81,000 for general promotions and \$22,000 for a motor vehicle.
- 1994 general fund revenues of \$104,500 were transferred to a debt service fund and used to repay \$100,000 of 9% 15-year term bonds, and to pay \$4,500 of interest. The bonds were used to acquire a citizens' center.
- At December 31, 1994, as a consequence of past services, city firefighters had accumulated entitlements to compensated absences valued at \$86,000. General fund resources available at December 31, 1994, are expected to be used to settle \$17,000 of this amount, and \$69,000 is expected to be paid out of future general fund resources.
- At December 31, 1994, Dane was responsible for \$83,000 of outstanding general fund encumbrances, including the \$8,000 for supplies indicated below.
- Dane uses the purchases method to account for supplies. The following information relates to supplies:

Inventory—1/1/94	\$ 39,000
12/31/94	42,000
Encumbrances outstanding—	
1/1/94	6,000
12/31/94	8,000
Purchase orders during 1994	190,000
Amounts credited to vouchers payable during 1994	181,000

Required:

For **Items 117 through 126**, determine the amounts based solely on the above information. To record your answer, blacken the ovals on the *Objective Answer Sheet*. If zeros precede your numerical answer, blacken the zeros in the ovals preceding your answer. **You cannot receive credit for your answers if you fail to blacken an oval in each column.** You may write the numbers in the boxes provided to facilitate blackening the ovals; however, the numbers written in the boxes will **not** be graded.

117. What is the amount of 1994 general fund operating transfers out?
118. How much should be reported as 1994 general fund liabilities from entitlements for compensated absences?
119. What is the 1994 reserved amount of the general fund balance?
120. What is the 1994 capital projects fund balance?
121. What is the 1994 fund balance on the special revenue fund for tourist promotion?
122. What is the amount of 1994 debt service fund expenditures?
123. What amount should be included in the general fixed assets account group for the cost of assets acquired in 1994?
124. What amount stemming from 1994 transactions and events decreased the liabilities reported in the general long-term debt account group?
125. Using the purchases method, what is the amount of 1994 supplies expenditures?
126. What was the total amount of 1994 supplies encumbrances?

E X A M I N A T I O N Q U E S T I O N S

UNIFORM CERTIFIED PUBLIC ACCOUNTANT EXAMINATION Financial Accounting & Reporting—Business Enterprises

CANDIDATE NUMBER						
Record your 7-digit candidate number in the boxes.						
Print your STATE name here.						

FARE

November 2, 1995; 1:30 P.M. to 6:00 P.M.

The point values for each question, and estimated time allotments based primarily on point value, are as follows:

	<i>Point Value</i>	<i>Estimated Minutes</i>	
		<i>Minimum</i>	<i>Maximum</i>
No. 1	60	130	140
No. 2	10	15	25
No. 3	10	15	25
No. 4	10	30	40
No. 5	10	30	40
Totals	100	220	270

INSTRUCTIONS TO CANDIDATES *Failure to follow these instructions may have an adverse effect on your Examination grade.*

1. Do not break the seal around the *Examination Questions* (pages 3 through 26) until you are told to do so.
 2. Question Numbers 1, 2, and 3 should be answered on the *Objective Answer Sheet*, which is pages 35 and 36. You should attempt to answer all objective items. There is no penalty for incorrect responses. Work space to solve the objective questions is provided in the *Examination Questions* on pages 5 through 21. Since the objective items are computer-graded, your comments and calculations associated with them are not considered. Be certain that you have entered your answers on the *Objective Answer Sheet* before the examination time is up. The objective portion of your examination will not be graded if you fail to record your answers on the *Objective Answer Sheet*. You will not be given additional time to record your answers.
 3. Question Numbers 4 and 5 should be answered beginning on page 27. Support all answers with properly labeled and legible calculations that can be identified as sources of amounts used to derive your final answer. If you have not completed answering a question on a page, fill in the appropriate spaces in the wording on the bottom of the page "**QUESTION NUMBER ____ CONTINUES ON PAGE ____ .**" If you have completed answering a question, fill in the appropriate space in the wording on the bottom of the page "**QUESTION NUMBER ____ ENDS ON THIS PAGE.**" Always begin the start of an answer to a question on the top of a new page (which may be the reverse side of a sheet of paper). Use the entire width of the page to answer requirements of a noncomputational nature. To answer requirements of a computational nature, you may wish to use the three vertical columns provided on the right side of each page.
 4. Although the primary purpose of the examination is to test your knowledge and application of the subject matter, selected essay responses will be graded for writing skills.
 5. You are required to turn in by the end of each session:
 - a. Attendance Record and Calculator Sign-off Record Form, page 1;
 - b. *Examination Questions*, pages 3 through 26;
 - c. *Essay Ruled Paper*, pages 27 through 34;
 - d. *Objective Answer Sheet*, pages 35 and 36;
 - e. Calculator; and
 - f. All unused examination materials.
- Your examination will not be graded unless the above listed items are handed in before leaving the examination room.

Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands of the United States.

Examination Questions Booklet No. _____

6. Unless otherwise instructed, if you want your *Examination Questions* mailed to you, write your name and address in both places indicated on page 26 and place 55 cents postage in the space provided. *Examination Questions* will be distributed no sooner than the day following the administration of this Examination.
7. To turn the calculator on press **CA**. The display will read “0.” The calculator automatically turns itself off approximately 8 minutes after the last entry. All data in the calculator will be lost once the calculator is off. We recommend that when you press **=**, you press **CA** before beginning a new calculation. The basic key descriptions are as follows:
- CA** **On and Clear**—Clears the calculator of all entries, including entries in memory, once the calculator is on.
 - CCE** **Clear Calculation**—Clears the display.
 - 0** ... **9** **Numericals**—Inputs that number.
 - .** **Decimal**—Indicates that all numbers to follow are decimals.
 - +/-** **Change sign**—Changes plus (minus) to minus (plus).

- + & -** **Add & Subtract**—Adds the next number entered to, or subtracts the next number entered from, the displayed number.
- ×** & **÷** **Multiply & Divide**—Multiplies or divides the displayed number by the next number entered.
- =** **Equal**—Displays the results of all previously entered operations.
- √** **Square Root**—Calculates the square root of the displayed number. It is unlikely that you will need to use this key during the exam.
- %** **Percentage**—Converts the displayed number to a percentage (i.e., divides it by 100) and completes all previously entered operations. It is unlikely that you will need to use this key during the exam.
- M+** **Memory Add**—Adds the displayed number to the balance in memory.
- M-** **Memory Subtract**—Subtracts the displayed number from the balance in memory.
- RCM** **Recall Memory**—Pressed once, displays the balance in memory. Pressed twice in a row, eliminates the balance in memory but not the displayed number.

If your calculator does not work or malfunctions, a replacement calculator will be available from the proctor.

Number 1 (Estimated time—130 to 140 minutes)

Select the **best** answer for each of the following items. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of correct answers.

1. According to the FASB conceptual framework, the objectives of financial reporting for business enterprises are based on

- A. Generally accepted accounting principles.
- B. Reporting on management's stewardship.
- C. The need for conservatism.
- D. The needs of the users of the information.

2. According to the FASB conceptual framework, the usefulness of providing information in financial statements is subject to the constraint of

- A. Consistency.
- B. Cost-benefit.
- C. Reliability.
- D. Representational faithfulness.

3. What is the underlying concept governing the generally accepted accounting principles pertaining to recording gain contingencies?

- A. Conservatism.
- B. Relevance.
- C. Consistency.
- D. Reliability.

4. A development stage enterprise should use the same generally accepted accounting principles that apply to established operating enterprises for

	<u>Revenue recognition</u>	<u>Deferral of expenses</u>
A.	Yes	Yes
B.	Yes	No
C.	No	No
D.	No	Yes

5. According to the FASB conceptual framework, which of the following attributes would **not** be used to measure inventory?

- A. Historical cost.
- B. Replacement cost.
- C. Net realizable value.
- D. Present value of future cash flows.

6. Conceptually, interim financial statements can be described as emphasizing

- A. Timeliness over reliability.
- B. Reliability over relevance.
- C. Relevance over comparability.
- D. Comparability over neutrality.

7. For which type of material related-party transactions does Statement of Financial Accounting Standard No. 57, *Related Party Disclosures*, require disclosure?

- A. Only those not reported in the body of the financial statements.
- B. Only those that receive accounting recognition.
- C. Those that contain possible illegal acts.
- D. All those other than compensation arrangements, expense allowances, and other similar items in the ordinary course of business.

MULTIPLE-CHOICE WORK SPACE—This information will **not** be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

Financial Accounting & Reporting — Business Enterprises

8. Terra Co.'s total revenues from its three business segments were as follows:

<u>Segment</u>	<u>Sales to unaffiliated customers</u>	<u>Intersegment sales</u>	<u>Total revenues</u>
Lion	\$ 70,000	\$30,000	\$100,000
Monk	22,000	4,000	26,000
Nevi	8,000	16,000	24,000
Combined	\$100,000	\$50,000	\$150,000
Elimination	—	(50,000)	(50,000)
Consolidated	<u>\$100,000</u>	<u>\$ —</u>	<u>\$100,000</u>

Which business segment(s) is (are) deemed to be reportable segments?

- A. None.
- B. Lion only.
- C. Lion and Monk only.
- ✓ D. Lion, Monk, and Nevi.

9. A company decided to change its inventory valuation method from FIFO to LIFO in a period of rising prices. What was the result of the change on ending inventory and net income in the year of the change?

	<u>Ending inventory</u>	<u>Net income</u>
A.	Increase	Increase
B.	Increase	Decrease
✓ C.	Decrease	Decrease
D.	Decrease	Increase

10. Lang Co. uses the installment method of revenue recognition. The following data pertain to Lang's installment sales for the years ended December 31, 1993 and 1994:

	<u>1993</u>	<u>1994</u>
Installment receivables at year-end on 1993 sales	\$60,000	\$30,000
Installment receivables at year-end on 1994 sales	—	69,000
Installment sales	80,000	90,000
Cost of sales	40,000	60,000

What amount should Lang report as deferred gross profit in its December 31, 1994, balance sheet?

- A. \$23,000
- B. \$33,000
- ✓ C. \$38,000
- D. \$43,000

11. In a sale-leaseback transaction, a gain resulting from the sale should be deferred at the time of the sale-leaseback and subsequently amortized when

- I. The seller-lessee has transferred substantially all the risks of ownership.
 - II. The seller-lessee retains the right to substantially all of the remaining use of the property.
- A. I only.
 - B. II only.
 - ✓ C. Both I and II.
 - D. Neither I nor II.

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

12. A six-year capital lease entered into on December 31, 1994, specified equal minimum annual lease payments due on December 31 of each year. The first minimum annual lease payment, paid on December 31, 1994, consists of which of the following?

	<u>Interest expense</u>	<u>Lease liability</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

13. Lime Co.'s payroll for the month ended January 31, 1995, is summarized as follows:

Total wages	\$10,000
Federal income tax withheld	1,200

All wages paid were subject to FICA. FICA tax rates were 7% each for employee and employer. Lime remits payroll taxes on the 15th of the following month. In its financial statements for the month ended January 31, 1995, what amounts should Lime report as total payroll tax liability and as payroll tax expense?

	<u>Liability</u>	<u>Expense</u>
A.	\$1,200	\$1,400
B.	\$1,900	\$1,400
C.	\$1,900	\$ 700
D.	\$2,600	\$ 700

Items 14 and 15 are based on the following:

The following information pertains to Hall Co.'s defined-benefit pension plan at December 31, 1994:

Unfunded accumulated benefit obligation	\$25,000
Unrecognized prior service cost	12,000
Net periodic pension cost	8,000

Hall made no contributions to the pension plan during 1994.

14. At December 31, 1994, what amount should Hall record as additional pension liability?

- A. \$ 5,000
- B. \$13,000
- C. \$17,000
- D. \$25,000

15. In its December 31, 1994, statement of stockholders' equity, what amount should Hall report as excess of additional pension liability over unrecognized prior service cost?

- A. \$ 5,000
- B. \$13,000
- C. \$17,000
- D. \$25,000

16. On March 1, 1993, Fine Co. borrowed \$10,000 and signed a two-year note bearing interest at 12% per annum compounded annually. Interest is payable in full at maturity on February 28, 1995. What amount should Fine report as a liability for accrued interest at December 31, 1994?

- A. \$0
- B. \$1,000
- C. \$1,200
- D. \$2,320

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

17. Eagle Co. has cosigned the mortgage note on the home of its president, guaranteeing the indebtedness in the event that the president should default. Eagle considers the likelihood of default to be remote. How should the guarantee be treated in Eagle's financial statements?

- A. Disclosed only.
- B. Accrued only.
- C. Accrued and disclosed.
- D. Neither accrued nor disclosed.

19. Cyan Corp. issued 20,000 shares of \$5 par common stock at \$10 per share. On December 31, 1993, Cyan's retained earnings were \$300,000. In March 1994, Cyan reacquired 5,000 shares of its common stock at \$20 per share. In June 1994, Cyan sold 1,000 of these shares to its corporate officers for \$25 per share. Cyan uses the cost method to record treasury stock. Net income for the year ended December 31, 1994, was \$60,000. At December 31, 1994, what amount should Cyan report as retained earnings?

- A. \$360,000
- B. \$365,000
- C. \$375,000
- D. \$380,000

18. Nest Co. issued 100,000 shares of common stock. Of these, 5,000 were held as treasury stock at December 31, 1993. During 1994, transactions involving Nest's common stock were as follows:

- May 3 — 1,000 shares of treasury stock were sold.
- August 6 — 10,000 shares of previously unissued stock were sold.
- November 18 — A 2-for-1 stock split took effect.

Laws in Nest's state of incorporation protect treasury stock from dilution. At December 31, 1994, how many shares of Nest's common stock were issued and outstanding?

	<i>Shares</i>	
	<i>Issued</i>	<i>Outstanding</i>
A.	220,000	212,000
B.	220,000	216,000
C.	222,000	214,000
D.	222,000	218,000

20. Asp Co. was organized on January 2, 1994, with 30,000 authorized shares of \$10 par common stock. During 1994 the corporation had the following capital transactions:

- January 5 — issued 20,000 shares at \$15 per share.
- July 14 — purchased 5,000 shares at \$17 per share.
- December 27 — reissued the 5,000 shares held in treasury at \$20 per share.

Asp used the par value method to record the purchase and reissuance of the treasury shares. In its December 31, 1994, balance sheet, what amount should Asp report as additional paid-in capital in excess of par?

- A. \$100,000
- B. \$125,000
- C. \$140,000
- D. \$150,000

MULTIPLE-CHOICE WORK SPACE—This information will **not** be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

21. A company issued rights to its existing shareholders without consideration. The rights allowed the recipients to purchase unissued common stock for an amount in excess of par value. When the rights are issued, which of the following accounts will be increased?

	<u>Common stock</u>	<u>Additional paid-in capital</u>
A.	Yes	Yes
B.	Yes	No
C.	No	No
D.	No	Yes

22. In September 1989, West Corp. made a dividend distribution of one right for each of its 120,000 shares of outstanding common stock. Each right was exercisable for the purchase of $\frac{1}{100}$ of a share of West's \$50 variable rate preferred stock at an exercise price of \$80 per share. On March 20, 1993, none of the rights had been exercised, and West redeemed them by paying each stockholder \$0.10 per right. As a result of this redemption, West's stockholders' equity was reduced by

- A. \$ 120
- B. \$ 2,400
- C. \$12,000
- D. \$36,000

23. During 1994, Young and Zinc maintained average capital balances in their partnership of \$160,000 and \$100,000, respectively. The partners receive 10% interest on average capital balances, and residual profit or loss is divided equally. Partnership profit before interest was \$4,000. By what amount should Zinc's capital account change for the year?

- A. \$ 1,000 decrease.
- B. \$ 2,000 increase.
- C. \$11,000 decrease.
- D. \$12,000 increase.

24. On February 1, 1995, Tory began a service proprietorship with an initial cash investment of \$2,000. The proprietorship provided \$5,000 of services in February and received full payment in March. The proprietorship incurred expenses of \$3,000 in February, which were paid in April. During March, Tory drew \$1,000 against the capital account. In the proprietorship's financial statements for the two months ended March 31, 1995, prepared under the cash basis method of accounting, what amount should be reported as capital?

- A. \$1,000
- B. \$3,000
- C. \$6,000
- D. \$7,000

25. The stockholders' equity section of Brown Co.'s December 31, 1994, balance sheet consisted of the following:

Common stock, \$30 par, 10,000	
shares authorized and outstanding	\$ 300,000
Additional paid-in capital	150,000
Retained earnings (deficit)	(210,000)

On January 2, 1995, Brown put into effect a stockholder-approved quasi-reorganization by reducing the par value of the stock to \$5 and eliminating the deficit against additional paid-in capital. Immediately after the quasi-reorganization, what amount should Brown report as additional paid-in capital?

- A. \$ (60,000)
- B. \$150,000
- C. \$190,000
- D. \$400,000

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

Items 26 through 28 are based on the following:

Grant, Inc. acquired 30% of South Co.'s voting stock for \$200,000 on January 2, 1993. Grant's 30% interest in South gave Grant the ability to exercise significant influence over South's operating and financial policies. During 1993, South earned \$80,000 and paid dividends of \$50,000. South reported earnings of \$100,000 for the six months ended June 30, 1994, and \$200,000 for the year ended December 31, 1994. On July 1, 1994, Grant sold half of its stock in South for \$150,000 cash. South paid dividends of \$60,000 on October 1, 1994.

26. Before income taxes, what amount should Grant include in its 1993 income statement as a result of the investment?

- A. \$15,000
- B. \$24,000
- C. \$50,000
- D. \$80,000

27. In Grant's December 31, 1993, balance sheet, what should be the carrying amount of this investment?

- A. \$200,000
- B. \$209,000
- C. \$224,000
- D. \$230,000

28. In its 1994 income statement, what amount should Grant report as gain from the sale of half of its investment?

- A. \$24,500
- B. \$30,500
- C. \$35,000
- D. \$45,500

29. Glade Co. leases computer equipment to customers under direct-financing leases. The equipment has no residual value at the end of the lease and the leases do not contain bargain purchase options. Glade wishes to earn 8% interest on a five-year lease of equipment with a fair value of \$323,400. The present value of an annuity due of \$1 at 8% for five years is 4.312. What is the total amount of interest revenue that Glade will earn over the life of the lease?

- A. \$ 51,600
- B. \$ 75,000
- C. \$129,360
- D. \$139,450

30. Rill Co. owns a 20% royalty interest in an oil well. Rill receives royalty payments on January 31 for the oil sold between the previous June 1 and November 30, and on July 31 for oil sold between the previous December 1 and May 31. Production reports show the following oil sales:

June 1, 1993—November 30, 1993	\$300,000
December 1, 1993—December 31, 1993	50,000
December 1, 1993—May 31, 1994	400,000
June 1, 1994—November 30, 1994	325,000
December 1, 1994—December 31, 1994	70,000

What amount should Rill report as royalty revenue for 1994?

- A. \$140,000
- B. \$144,000
- C. \$149,000
- D. \$159,000

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

Examination Questions — November 1995

31. It is proper to recognize revenue prior to the sale of merchandise when

- I. The revenue will be reported as an installment sale.
 - II. The revenue will be reported under the cost recovery method.
- A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

32. Fogg Co., a U.S. company, contracted to purchase foreign goods. Payment in foreign currency was due one month after the goods were received at Fogg's warehouse. Between the receipt of goods and the time of payment, the exchange rates changed in Fogg's favor. The resulting gain should be included in Fogg's financial statements as a(an)

- A. Component of income from continuing operations.
- B. Extraordinary item.
- C. Deferred credit.
- D. Separate component of stockholders' equity.

33. Gray Co. was granted a patent on January 2, 1991, and appropriately capitalized \$45,000 of related costs. Gray was amortizing the patent over its estimated useful life of fifteen years. During 1994, Gray paid \$15,000 in legal costs in successfully defending an attempted infringement of the patent. After the legal action was completed, Gray sold the patent to the plaintiff for \$75,000. Gray's policy is to take no amortization in the year of disposal. In its 1994 income statement, what amount should Gray report as gain from sale of patent?

- A. \$15,000
- B. \$24,000
- C. \$27,000
- D. \$39,000

34. When should a lessor recognize in income a nonrefundable lease bonus paid by a lessee on signing an operating lease?

- A. When received.
- B. At the inception of the lease.
- C. At the expiration of the lease.
- D. Over the life of the lease.

35. Upon the death of an officer, Jung Co. received the proceeds of a life insurance policy held by Jung on the officer. The proceeds were not taxable. The policy's cash surrender value had been recorded on Jung's books at the time of payment. What amount of revenue should Jung report in its statements?

- A. Proceeds received.
- B. Proceeds received less cash surrender value.
- C. Proceeds received plus cash surrender value.
- D. None.

36. On its December 31, 1994, balance sheet, Shin Co. had income taxes payable of \$13,000 and a current deferred tax asset of \$20,000 before determining the need for a valuation account. Shin had reported a current deferred tax asset of \$15,000 at December 31, 1993. No estimated tax payments were made during 1994. At December 31, 1994, Shin determined that it was more likely than not that 10% of the deferred tax asset would not be realized. In its 1994 income statement, what amount should Shin report as total income tax expense?

- A. \$ 8,000
- B. \$ 8,500
- ✓ C. \$10,000
- D. \$13,000

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

Items 37 and 38 are based on the following:

Zeff Co. prepared the following reconciliation of its pretax financial statement income to taxable income for the year ended December 31, 1994, its first year of operations:

Pretax financial income	\$160,000
Nontaxable interest received on municipal securities	(5,000)
Long-term loss accrual in excess of deductible amount	10,000
Depreciation in excess of financial statement amount	(25,000)
Taxable income	<u>\$140,000</u>

Zeff's tax rate for 1994 is 40%.

39. During January 1993, Doe Corp. agreed to sell the assets and product line of its Hart division. The sale was completed on January 15, 1994, and resulted in a gain on disposal of \$900,000. Hart's operating losses were \$600,000 for 1993 and \$50,000 for the period January 1 through January 15, 1994. Disregarding income taxes, what amount of net gain(loss) should be reported in Doe's comparative 1994 and 1993 income statements?

	<i>1994</i>	<i>1993</i>
A.	\$0	\$ 250,000
B.	\$250,000	\$0
C.	\$850,000	\$(600,000)
D.	\$900,000	\$(650,000)

37. In its 1994 income statement, what amount should Zeff report as income tax expense—current portion?

- A. \$52,000
- B. \$56,000
- C. \$62,000
- D. \$64,000

38. In its December 31, 1994, balance sheet, what should Zeff report as deferred income tax liability?

- A. \$2,000
- B. \$4,000
- C. \$6,000
- D. \$8,000

40. On April 30, 1994, Deer Corp. approved a plan to dispose of a segment of its business. For the period January 1 through April 30, 1994, the segment had revenues of \$500,000 and expenses of \$800,000. The assets of the segment were sold on October 15, 1994, at a loss for which no tax benefit is available. In its income statement for the year ended December 31, 1994, how should Deer report the segment's operations from January 1 to April 30, 1994?

- A. \$500,000 and \$800,000 should be included with revenues and expenses, respectively, as part of continuing operations.
- B. \$300,000 should be reported as part of the loss on disposal of a segment.
- C. \$300,000 should be reported as an extraordinary loss.
- D. \$300,000 should be reported as a loss from operations of a discontinued segment.

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

41. In open market transactions, Gold Corp. simultaneously sold its long-term investment in Iron Corp. bonds and purchased its own outstanding bonds. The broker remitted the net cash from the two transactions. Gold's gain on the purchase of its own bonds exceeded its loss on the sale of the Iron bonds. Gold should report the

- A. Net effect of the two transactions as an extraordinary gain.
- B. Net effect of the two transactions in income before extraordinary items.
- C. Effect of its own bond transaction gain in income before extraordinary items, and report the Iron bond transaction as an extraordinary loss.
- D. Effect of its own bond transaction as an extraordinary gain, and report the Iron bond transaction loss in income before extraordinary items.

42. During 1994 both Raim Co. and Cane Co. suffered losses due to the flooding of the Mississippi River. Raim is located two miles from the river and sustains flood losses every two to three years. Cane, which has been located fifty miles from the river for the past twenty years, has never before had flood losses. How should the flood losses be reported in each company's 1994 income statement?

<u>Raim</u>	<u>Cane</u>
A. As a component of income from continuing operations	As an extraordinary item
B. As a component of income from continuing operations	As a component of income from continuing operations
C. As an extraordinary item	As a component of income from continuing operations
D. As an extraordinary item	As an extraordinary item

43. Lore Co. changed from the cash basis of accounting to the accrual basis of accounting during 1994. The cumulative effect of this change should be reported in Lore's 1994 financial statements as a

- A. Prior period adjustment resulting from the correction of an error.
- B. Prior period adjustment resulting from the change in accounting principle.
- C. Component of income before extraordinary item.
- D. Component of income after extraordinary item.

44. Oak Co. offers a three-year warranty on its products. Oak previously estimated warranty costs to be 2% of sales. Due to a technological advance in production at the beginning of 1994, Oak now believes 1% of sales to be a better estimate of warranty costs. Warranty costs of \$80,000 and \$96,000 were reported in 1992 and 1993, respectively. Sales for 1994 were \$5,000,000. What amount should be disclosed in Oak's 1994 financial statements as warranty expense?

- A. \$ 50,000
- B. \$ 88,000
- C. \$100,000
- D. \$138,000

OTHER OBJECTIVE ANSWER FORMAT WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

45. Ute Co. had the following capital structure during 1993 and 1994:

Preferred stock, \$10 par, 4% cumulative, 25,000 shares issued and outstanding	\$ 250,000
Common stock, \$5 par, 200,000 shares issued and outstanding	1,000,000

Preferred stock is not considered a common stock equivalent. Ute reported net income of \$500,000 for the year ended December 31, 1994. Ute paid no preferred dividends during 1993 and paid \$16,000 in preferred dividends during 1994. In its December 31, 1994, income statement, what amount should Ute report as earnings per share?

- A. \$2.42
- B. \$2.45
- C. \$2.48
- D. \$2.50

46. West Co. had earnings per share of \$15.00 for 1994 before considering the effects of any convertible securities. No conversion or exercise of convertible securities occurred during 1994. However, possible conversion of convertible bonds, not considered common stock equivalents, would have reduced earnings per share by \$0.75. The effect of possible exercise of common stock options would have increased earnings per share by \$0.10. What amount should West report as primary earnings per share for 1994?

- A. \$14.25
- B. \$14.35
- C. \$15.00
- D. \$15.10

47. Mend Co. purchased a three-month U.S. Treasury bill. Mend's policy is to treat as cash equivalents all highly liquid investments with an original maturity of three months or less when purchased. How should this purchase be reported in Mend's statement of cash flows?

- A. As an outflow from operating activities.
- B. As an outflow from investing activities.
- C. As an outflow from financing activities.
- D. Not reported.

48. Which of the following is **not** disclosed on the statement of cash flows when prepared under the direct method, either on the face of the statement or in a separate schedule?

- A. The major classes of gross cash receipts and gross cash payments.
- B. The amount of income taxes paid.
- C. A reconciliation of net income to net cash flow from operations.
- D. A reconciliation of ending retained earnings to net cash flow from operations.

Items 49 through 51 are based on the following:

On January 2, 1994, Pare Co. purchased 75% of Kidd Co.'s outstanding common stock. Selected balance sheet data at December 31, 1994, is as follows:

	<u>Pare</u>	<u>Kidd</u>
Total assets	\$420,000	\$180,000
Liabilities	\$120,000	\$ 60,000
Common stock	100,000	50,000
Retained earnings	200,000	70,000
	<u>\$420,000</u>	<u>\$180,000</u>

During 1994, Pare and Kidd paid cash dividends of \$25,000 and \$5,000, respectively, to their shareholders. There were no other intercompany transactions.

MULTIPLE-CHOICE WORK SPACE—This information will **not** be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

49. In its December 31, 1994, consolidated statement of retained earnings, what amount should Pare report as dividends paid?

- A. \$ 5,000
- B. \$25,000
- C. \$26,250
- D. \$30,000

50. In Pare's December 31, 1994, consolidated balance sheet, what amount should be reported as minority interest in net assets?

- A. \$0
- B. \$ 30,000
- C. \$ 45,000
- D. \$105,000

51. In its December 31, 1994, consolidated balance sheet, what amount should Pare report as common stock?

- A. \$ 50,000
- B. \$100,000
- C. \$137,500
- D. \$150,000

52. In a business combination, how should long-term debt of the acquired company generally be reported under each of the following methods?

	<u>Pooling of interest</u>	<u>Purchase</u>
A.	Fair value	Carrying amount
B.	Fair value	Fair value
C.	Carrying amount	Fair value
D.	Carrying amount	Carrying amount

53. In a business combination accounted for as a purchase, the appraised values of the identifiable assets acquired exceeded the acquisition price. How should the excess appraised value be reported?

- A. As negative goodwill.
- B. As additional paid-in capital.
- C. As a reduction of the values assigned to noncurrent assets and a deferred credit for any unallocated portion.
- D. As positive goodwill.

54. A business interest that constitutes a large part of an individual's total assets should be presented in a personal statement of financial condition as

- A. A separate listing of the individual assets and liabilities at cost.
- B. Separate line items of both total assets and total liabilities at cost.
- C. A single amount equal to the proprietorship equity.
- D. A single amount equal to the estimated current value of the business interest.

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

55. Quinn is preparing a personal statement of financial condition as of April 30, 1995. Included in Quinn's assets are the following:

- 50% of the voting stock of Ink Corp. A stockholders' agreement restricts the sale of the stock and, under certain circumstances, requires Ink to repurchase the stock. Quinn's tax basis for the stock is \$430,000, and at April 30, 1995, the buyout value is \$675,000.
- Jewelry with a fair value aggregating \$70,000 based on an independent appraisal on April 30, 1995, for insurance purposes. This jewelry was acquired by purchase and gift over a 10-year period and has a total tax basis of \$40,000.

What is the total amount at which the Ink stock and jewelry should be reported in Quinn's April 30, 1995, personal statement of financial condition?

- A. \$470,000
- B. \$500,000
- C. \$715,000
- D. \$745,000

56. In financial statements prepared on the income-tax basis, how should the nondeductible portion of expenses such as meals and entertainment be reported?

- A. Included in the expense category in the determination of income.
- B. Included in a separate category in the determination of income.
- C. Excluded from the determination of income but included in the determination of retained earnings.
- D. Excluded from the financial statements.

57. Financial statements prepared under which of the following methods include adjustments for both specific price changes and general price-level changes?

- A. Historical cost/nominal dollar.
- B. Current cost/nominal dollar.
- C. Current cost/constant dollar.
- D. Historical cost/constant dollar.

58. What effect would the sale of a company's trading securities at their carrying amounts for cash have on each of the following ratios?

	<u>Current ratio</u>	<u>Quick ratio</u>
A.	No effect	No effect
B.	Increase	Increase
C.	No effect	Increase
D.	Increase	No effect

59. Barr Co. has total debt of \$420,000 and stockholders' equity of \$700,000. Barr is seeking capital to fund an expansion. Barr is planning to issue an additional \$300,000 in common stock, and is negotiating with a bank to borrow additional funds. The bank is requiring a debt-to-equity ratio of .75. What is the maximum additional amount Barr will be able to borrow?

- A. \$225,000
- B. \$330,000
- C. \$525,000
- D. \$750,000

60. The following data pertain to Cowl, Inc., for the year ended December 31, 1994:

Net sales	\$ 600,000
Net income	150,000
Total assets, January 1, 1994	2,000,000
Total assets, December 31, 1994	3,000,000

What was Cowl's rate of return on assets for 1994?

- A. 5%
- B. 6%
- C. 20%
- D. 24%

MULTIPLE-CHOICE WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

Number 2 (Estimated time—15 to 25 minutes)

Question Number 2 consists of 10 items. Select the **best** answer for each item. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Answer all items.** Your grade will be based on the total number of correct answers.

Items 61 through 64 are based on the following:

Camp Co. purchased various securities during 1994 to be classified as held-to-maturity securities, trading securities, or available-for-sale securities.

Required:

Items 61 through 64 describe various securities purchased by Camp. For each item, select from the following list the appropriate category for each security and blacken the corresponding oval on the *Objective Answer Sheet*. A category may be used once, more than once, or not at all.

<i>Categories</i>	
<input type="radio"/>	Held-to-maturity.
<input type="radio"/>	Trading.
<input type="radio"/>	Available-for-sale.

61. Debt securities bought and held for the purpose of selling in the near term.
 62. U.S. Treasury bonds that Camp has both the positive intent and the ability to hold to maturity.
 63. \$3 million debt security bought and held for the purpose of selling in three years to finance payment of Camp's \$2 million long-term note payable when it matures.
 64. Convertible preferred stock that Camp does not intend to sell in the near term.
-

Number 2 (continued)

Items 65 through 70 are based on the following:

The following information pertains to Dayle, Inc.'s portfolio of marketable investments for the year ended December 31, 1994:

	<u>Cost</u>	<u>Fair value, 12/31/93</u>	<u>1994 activity</u>		<u>Fair value, 12/31/94</u>
			<u>Purchases</u>	<u>Sales</u>	
<u>Held-to-maturity securities</u>					
Security ABC			\$100,000		\$ 95,000
<u>Trading securities</u>					
Security DEF	\$150,000	\$160,000			155,000
<u>Available-for-sale securities</u>					
Security GHI	190,000	165,000		\$175,000	
Security JKL	170,000	175,000			160,000

Security ABC was purchased at par. All declines in fair value are considered to be temporary.

Required:

Items 65 through 70 describe amounts to be reported in Dayle's 1994 financial statements. For each item, select from the following list the correct numerical response and blacken the corresponding oval on the *Objective Answer Sheet*. An amount may be selected once, more than once, or not at all. Ignore income tax considerations.

- 65. Carrying amount of security ABC at December 31, 1994.
- 66. Carrying amount of security DEF at December 31, 1994.
- 67. Carrying amount of security JKL at December 31, 1994.

Items 68 through 70 require a second response. For each item, indicate whether a gain ☉ or a loss ☹ is to be reported and blacken the corresponding oval on the *Objective Answer Sheet*.

- 68. Recognized gain or loss on sale of security GHI.
- 69. Unrealized gain or loss to be reported in 1994 income statement.
- 70. Unrealized gain or loss to be reported at December 31, 1994, as a separate component of stockholders' equity.

<i>Answer List</i>	
Ⓐ	\$0
Ⓑ	\$ 5,000
Ⓒ	\$ 10,000
Ⓓ	\$ 15,000
Ⓔ	\$ 25,000
Ⓕ	\$ 95,000
Ⓖ	\$100,000
Ⓗ	\$150,000
Ⓘ	\$155,000
Ⓙ	\$160,000
Ⓚ	\$170,000

Number 3 (Estimated time—15 to 25 minutes)

Question Number 3 consists of 13 items. Select the **best** answer for each item. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Answer all items.** Your grade will be based on the total number of correct answers.

Items 71 through 77 are based on the following:

On January 2, 1994, North Co. issued bonds payable with a face value of \$480,000 at a discount. The bonds are due in 10 years and interest is payable semiannually every June 30 and December 31. On June 30, 1994, and on December 31, 1994, North made the semiannual interest payments due, and recorded interest expense and amortization of bond discount.

Required:

Items 71 through 77, contained in the partially-completed amortization table below, represent information needed to complete the table. For each item, select from the following lists the correct numerical response and blacken the corresponding oval on the *Objective Answer Sheet*. A response may be selected once, more than once, or not at all.

Rates	
(A)	3.0%
(B)	4.5%
(C)	5.0%
(D)	6.0%
(E)	9.0%
(F)	10.0%

Amounts			
(G) \$	3,420	(P) \$	21,600
(H) \$	3,600	(Q) \$	116,400
(I) \$	3,780	(R) \$	120,000
(J) \$	3,960	(S) \$	123,600
(K) \$	14,400	(T) \$	360,000
(L) \$	17,820	(U) \$	363,600
(M) \$	18,000	(V) \$	367,200
(N) \$	18,180	(W) \$	467,400
(O) \$	18,360	(X) \$	480,000

	Cash	Interest expense	Amortization	Discount	Carrying amount
1/2/94					(73)
6/30/94	(72)	18,000	3,600	(71)	363,600
12/31/94	\$14,400	(76)	(77)		

Annual Interest Rates: Stated (74)
Effective (75)

OTHER OBJECTIVE ANSWER FORMAT WORK SPACE—This information will **not** be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

Number 3 (continued)

Items 78 through 83 are based on the following:

Town, Inc. is preparing its financial statements for the year ended December 31, 1994.

Required:

Items 78 through 83 represent various commitments and contingencies of Town at December 31, 1994, and events subsequent to December 31, 1994, but prior to the issuance of the 1994 financial statements. For each item, select from the following list the reporting requirement and blacken the corresponding oval on the *Objective Answer Sheet*. A reporting requirement may be selected once, more than once, or not at all.

<i>Reporting Requirement</i>
<input type="radio"/> Disclosure only.
<input type="radio"/> Accrual only.
<input type="radio"/> Both accrual and disclosure.
<input type="radio"/> Neither accrual nor disclosure.

78. On December 1, 1994, Town was awarded damages of \$75,000 in a patent infringement suit it brought against a competitor. The defendant did not appeal the verdict, and payment was received in January 1995.
79. A former employee of Town has brought a wrongful-dismissal suit against Town. Town's lawyers believe the suit to be without merit.
80. At December 31, 1994, Town had outstanding purchase orders in the ordinary course of business for purchase of a raw material to be used in its manufacturing process. The market price is currently higher than the purchase price and is not anticipated to change within the next year.
81. A government contract completed during 1994 is subject to renegotiation. Although Town estimates that it is reasonably possible that a refund of approximately \$200,000–\$300,000 may be required by the government, it does not wish to publicize this possibility.
82. Town has been notified by a governmental agency that it will be held responsible for the cleanup of toxic materials at a site where Town formerly conducted operations. Town estimates that it is probable that its share of remedial action will be approximately \$500,000.
83. On January 5, 1995, Town redeemed its outstanding bonds and issued new bonds with a lower rate of interest. The reacquisition price was in excess of the carrying amount of the bonds.

OTHER OBJECTIVE ANSWER FORMAT WORK SPACE—This information will not be graded. Only answers recorded on the *Objective Answer Sheet* will be graded.

Number 4 (Estimated time—30 to 40 minutes)

The following information pertains to Baron Flowers, a calendar-year sole proprietorship, which maintained its books on the cash basis during the year.

Baron Flowers
TRIAL BALANCE
December 31, 1994

	<i>Dr.</i>	<i>Cr.</i>
Cash	\$ 25,600	
Accounts receivable, 12/31/93	16,200	
Inventory, 12/31/93	62,000	
Furniture & fixtures	118,200	
Land improvements	45,000	
Accumulated depreciation, 12/31/93		\$ 32,400
Accounts payable, 12/31/93		17,000
Baron, Drawings		
Baron, Capital, 12/31/93		124,600
Sales		653,000
Purchases	305,100	
Salaries	174,000	
Payroll taxes	12,400	
Insurance	8,700	
Rent	34,200	
Utilities	12,600	
Living expenses	13,000	
	\$827,000	\$827,000

Baron has developed plans to expand into the wholesale flower market and is in the process of negotiating a bank loan to finance the expansion. The bank is requesting 1994 financial statements prepared on the accrual basis of accounting from Baron. During the course of a review engagement, Muir, Baron's accountant, obtained the following additional information.

1. Amounts due from customers totaled \$32,000 at December 31, 1994.
2. An analysis of the above receivables revealed that an allowance for uncollectible accounts of \$3,800 should be provided.
3. Unpaid invoices for flower purchases totaled \$30,500 and \$17,000, at December 31, 1994, and December 31, 1993, respectively.
4. The inventory totaled \$72,800 based on a physical count of the goods at December 31, 1994. The inventory was priced at cost, which approximates market value.
5. On May 1, 1994, Baron paid \$8,700 to renew its comprehensive insurance coverage for one year. The premium on the previous policy, which expired on April 30, 1994, was \$7,800.
6. On January 2, 1994, Baron entered into a twenty-five-year operating lease for the vacant lot adjacent to Baron's retail store for use as a parking lot. As agreed in the lease, Baron paved and fenced in the lot at a cost of \$45,000. The improvements were completed on April 1, 1994, and have an estimated useful life of fifteen years. No provision for depreciation or amortization has been recorded. Depreciation on furniture and fixtures was \$12,000 for 1994.

Number 4 (continued)

7. Accrued expenses at December 31, 1993 and 1994, were as follows:

	<u>1993</u>	<u>1994</u>
Utilities	\$ 900	\$1,500
Payroll taxes	1,100	1,600
	<u>\$2,000</u>	<u>\$3,100</u>

8. Baron is being sued for \$400,000. The coverage under the comprehensive insurance policy is limited to \$250,000. Baron's attorney believes that an unfavorable outcome is probable and that a reasonable estimate of the settlement is \$300,000.
9. The salaries account includes \$4,000 per month paid to the proprietor. Baron also receives \$250 per week for living expenses.

Required:

a. Using the worksheet on page 27 of your *Essay Ruled Paper*, prepare the adjustments necessary to convert the trial balance of Baron Flowers to the accrual basis of accounting for the year ended December 31, 1994. Formal journal entries are not required to support your adjustments. However, use the numbers given with the additional information to cross-reference the postings in the adjustment columns on the worksheet.

b. Write a brief memo to Baron explaining why the bank would require financial statements prepared on the accrual basis instead of the cash basis.

Number 4

a.

Baron Flowers
WORKSHEET TO CONVERT TRIAL BALANCE TO ACCRUAL BASIS
December 31, 1994

Account title	Cash basis		Adjustments		Accrual Basis*	
	Dr.	Cr.	Dr.	Cr.	Dr.*	Cr.*
Cash	25,600					
Accounts receivable	16,200					
Inventory	62,000					
Furniture & fixtures	118,200					
Land improvements	45,000					
Accumulated depreciation & amortization		32,400				
Accounts payable		17,000				
Baron, Drawings						
Baron, Capital		124,600				
Sales		653,000				
Purchases	305,100					
Salaries	174,000					
Payroll taxes	12,400					
Insurance	8,700					
Rent	34,200					
Utilities	12,600					
Living expenses	13,000					
	827,000	827,000				

* Completion of these columns is not required.

Number 5 (Estimated time—30 to 40 minutes)

During 1994, Broca Co. had the following transactions:

- On January 2, Broca purchased the net assets of Amp Co. for \$360,000. The fair value of Amp's identifiable net assets was \$172,000. Broca believes that, due to the popularity of Amp's consumer products, the life of the resulting goodwill is unlimited.
- On February 1, Broca purchased a franchise to operate a ferry service from the state government for \$60,000 and an annual fee of 1% of ferry revenues. The franchise expires after five years. Ferry revenues were \$20,000 during 1994. Broca projects future revenues of \$40,000 in 1995, and \$60,000 per annum for the three years thereafter.
- On April 5, Broca was granted a patent that had been applied for by Amp. During 1994, Broca incurred legal costs of \$51,000 to register the patent and an additional \$85,000 to successfully prosecute a patent infringement suit against a competitor. Broca estimates the patent's economic life to be ten years.

Broca's accounting policy is to amortize all intangibles on the straight-line basis over the maximum period permitted by generally accepted accounting principles, taking a full year's amortization in the year of acquisition.

Required:


a. 1. Describe the characteristics of intangible assets. Discuss the accounting for the purchase or internal development of intangible assets with an indeterminable life, such as goodwill.

2. Over what period should intangible assets be amortized? How should this period be determined? Discuss the justification for amortization of intangible assets with indeterminable lives.

3. Describe the financial statement disclosure requirements relating to Broca's intangible assets and expenses. Do not write the related footnotes.

b. Prepare a schedule showing the intangibles section of Broca's balance sheet at December 31, 1994, and a schedule showing the related expenses that would appear on Broca's 1994 income statement. Show supporting computations.

OBJECTIVE ANSWER SHEET

- Record your 7-digit candidate number in the boxes on the right, then **blacken completely the oval for each digit you have recorded.**
- Use a Number 2 pencil. 
- Erase clearly any marks you wish to change. **Make no stray marks on this sheet.**

• **INCORRECT MARKS**  **CORRECT MARK** 

UNIFORM CERTIFIED PUBLIC ACCOUNTANT EXAMINATION
Business Law & Professional Responsibilities

For Proctor Use Only

LPR

VERSION 1

November 1, 1995; 9:00 A.M. to 12:00 NOON

(60 points)

CANDIDATE NUMBER						
0	1	2	3	4	5	6
7	8	9	0	1	2	3
4	5	6	7	8	9	0
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8	9	0	1	2	3	4
5	6	7	8	9	0	1
2	3	4	5	6	7	8
9	0	1	2	3	4	5
6	7	8	9	0	1	2
3	4	5	6	7	8	9
4	5	6	7	8	9	0
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7	8	9	0	1	2	3
8	9	0	1	2	3	4
9	0	1	2	3	4	5
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3	4	5	6	7	8	9
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5	6	7	8	9	0	1
6	7	8	9	0	1	2
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3	4	5	6	7	8	9
4	5	6	7	8	9	0
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7	8	9	0	1	2	3
8	9	0	1	2	3	4
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1	2	3	4	5	6	7
2	3	4	5	6	7	8
3	4	5	6	7	8	9
4	5	6	7	8	9	0
5	6	7	8	9	0	1
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7	8	9	0	1	2	3
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9	0	1	2	3	4	5
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3	4	5	6	7	8	9
4	5	6	7	8	9	0
5	6	7	8	9	0	1
6	7	8	9	0	1	2
7	8	9	0	1	2	3
8	9	0	1	2	3	4
9	0	1	2	3	4	5
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1	2	3	4	5	6	7
2	3	4	5	6	7	8
3	4	5	6	7	8	9
4	5	6	7	8	9	0
5	6	7	8	9	0	1
6	7	8	9	0	1	2
7	8	9	0	1	2	3
8	9	0	1	2	3	4
9	0	1	2	3	4	5
0	1					

(10 points)

ANSWERS 2	a. Item	Select one			
	61	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
	62	<input checked="" type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
	63	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
	64	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input checked="" type="radio"/> D
	65	<input checked="" type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D

b. Item	Select one			
66	<input type="radio"/> A	<input type="radio"/> B	<input checked="" type="radio"/> C	<input type="radio"/> D
67	<input checked="" type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
68	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
69	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
70	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input checked="" type="radio"/> D



(10 points)

ANSWERS 3	a. Item	Select one			
	71	<input checked="" type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
	72	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
	73	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
	74	<input type="radio"/> A	<input type="radio"/> B	<input checked="" type="radio"/> C	<input type="radio"/> D
	75	<input checked="" type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D

b. Item	Select one			
76	<input checked="" type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
77	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
78	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
79	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
80	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input checked="" type="radio"/> D



Answer 4 (10 points)

a. Korn would argue two points of law to show there was no valid contract. Korn would argue that the July 5 offer was not accepted by Wilson before it was withdrawn on September 30. An offer can be withdrawn at any time before it is accepted even if it states that it will remain open for a definite period of time.

Korn would also argue that Wilson's response of September 28 was not a valid acceptance because Wilson included additional terms and Wilson's attempt to change the term of the contract was a rejection and a counteroffer.

b. Wilson would argue two points of law to show there was a valid contract. Wilson would argue that the mailing of the acceptance on September 28 was an effective acceptance under the mailbox rule. There is a valid contract because there was a valid acceptance before the offer was withdrawn.

Wilson would also argue that the attempt to extend the contract was not a condition of acceptance but a requested immaterial modification that did not negate the acceptance.

c. If a valid contract existed, Korn's September 30 telephone call resulted in Korn's anticipatory breach of the contract because Wilson could no longer rely on Korn performing.

Under common law, Wilson could either cancel the contract or sue to collect compensatory damages for the additional amount it would cost to obtain the services.

Answer 5 (10 points)

To:

From:

I have identified and explained the issues and offer my conclusions on the legal issues pertaining to the attached note and security interest:

- Is Crane a holder in due course?

Crane is a holder in due course because Crane took a negotiable note for value, in good faith, and without knowledge of any defenses by the maker. The later disclosure that Oval has a personal defense against Jones does not affect that status as a holder in due course.

- Will Crane be able to collect from Oval?

Crane should be able to collect from Oval because Oval's defense is personal and a holder in due course is not subject to personal defenses.


- Will Crane be able to collect from Jones?

Crane should be able to collect from Jones despite Jones' qualified indorsement (without recourse) of the note. Jones was aware of Oval's defense of fraud at the time Jones indorsed the note to Crane. This knowledge is a breach of the implied transfer warranty against defenses. Accordingly, Jones' qualified indorsement does not prevent Crane from collecting the note from Jones.

- Was Crane's security interest perfected and does it have priority over Acorn's security interest?

The perfection of the security interest relates back to the date Harper took possession of the tractor (collateral) (October 5, 1995) because the security interest was a non-inventory purchase money security interest, and the financing statement was filed on October 10, 1995 (within the statutory filing period). Accordingly, Crane's security interest has priority over Acorn's security interest despite Acorn's earlier filing on October 9, 1995.

OBJECTIVE ANSWER SHEET

- Record your 7-digit candidate number in the boxes on the right, then blacken completely the oval for each digit you have recorded.
- Use a Number 2 pencil. 
- Erase clearly any marks you wish to change. Make no stray marks on this sheet.

INCORRECT MARKS  CORRECT MARK 

CANDIDATE NUMBER

0	0	0	0	0	0	0
1	1	1	1	1	1	1
2	2	2	2	2	2	2
3	3	3	3	3	3	3
4	4	4	4	4	4	4
5	5	5	5	5	5	5
6	6	6	6	6	6	6
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8	8	8	8	8	8	8
9	9	9	9	9	9	9

Print your **STATE** name here.

UNIFORM CERTIFIED PUBLIC ACCOUNTANT EXAMINATION

Auditing

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AUDIT

VERSION 1

November 1, 1995; 1:30 P.M. to 6:00 P.M.

(60 points)

Objective Answer Sheets may vary from examination to examination. Be certain that your answer corresponds directly in number with the examination item.

ANSWERS	1	A	B	C	<input checked="" type="radio"/>	26	A	B	C	<input checked="" type="radio"/>	51	A	B	<input checked="" type="radio"/>	D	76	A	B	C	<input checked="" type="radio"/>
	2	<input checked="" type="radio"/>	B	C	D	27	A	B	<input checked="" type="radio"/>	D	52	<input checked="" type="radio"/>	B	C	D	77	<input checked="" type="radio"/>	B	C	D
	3	A	<input checked="" type="radio"/>	C	D	28	<input checked="" type="radio"/>	B	C	D	53	A	B	C	<input checked="" type="radio"/>	78	<input checked="" type="radio"/>	B	C	D
	4	A	<input checked="" type="radio"/>	C	D	29	A	B	C	<input checked="" type="radio"/>	54	A	B	C	<input checked="" type="radio"/>	79	A	B	<input checked="" type="radio"/>	D
	5	A	<input checked="" type="radio"/>	C	D	30	A	B	C	<input checked="" type="radio"/>	55	A	B	<input checked="" type="radio"/>	D	80	A	B	<input checked="" type="radio"/>	D
	6	A	B	<input checked="" type="radio"/>	D	31	<input checked="" type="radio"/>	B	C	D	56	A	B	C	<input checked="" type="radio"/>	81	<input checked="" type="radio"/>	B	C	D
	7	A	B	<input checked="" type="radio"/>	D	32	A	B	<input checked="" type="radio"/>	D	57	A	<input checked="" type="radio"/>	C	D	82	<input checked="" type="radio"/>	B	C	D
	8	A	B	C	<input checked="" type="radio"/>	33	<input checked="" type="radio"/>	B	C	D	58	A	B	<input checked="" type="radio"/>	D	83	<input checked="" type="radio"/>	B	C	D
	9	<input checked="" type="radio"/>	B	C	D	34	A	B	C	<input checked="" type="radio"/>	59	A	B	C	<input checked="" type="radio"/>	84	A	<input checked="" type="radio"/>	C	D
	10	A	B	<input checked="" type="radio"/>	D	35	A	B	C	<input checked="" type="radio"/>	60	A	B	C	<input checked="" type="radio"/>	85	A	B	<input checked="" type="radio"/>	D
	11	A	B	<input checked="" type="radio"/>	D	36	A	B	<input checked="" type="radio"/>	D	61	A	B	<input checked="" type="radio"/>	D	86	<input checked="" type="radio"/>	B	C	D
	12	<input checked="" type="radio"/>	B	C	D	37	<input checked="" type="radio"/>	B	C	D	62	A	B	<input checked="" type="radio"/>	D	87	<input checked="" type="radio"/>	B	C	D
	13	<input checked="" type="radio"/>	B	C	D	38	<input checked="" type="radio"/>	B	C	D	63	A	<input checked="" type="radio"/>	C	D	88	A	<input checked="" type="radio"/>	C	D
	14	A	<input checked="" type="radio"/>	C	D	39	A	B	<input checked="" type="radio"/>	D	64	A	B	C	<input checked="" type="radio"/>	89	A	<input checked="" type="radio"/>	C	D
	15	<input checked="" type="radio"/>	B	C	D	40	A	<input checked="" type="radio"/>	C	D	65	A	B	C	<input checked="" type="radio"/>	90	A	<input checked="" type="radio"/>	C	D
	16	A	<input checked="" type="radio"/>	C	D	41	A	<input checked="" type="radio"/>	C	D	66	A	<input checked="" type="radio"/>	C	D					
	17	A	B	<input checked="" type="radio"/>	D	42	A	<input checked="" type="radio"/>	C	D	67	<input checked="" type="radio"/>	B	C	D					
	18	A	<input checked="" type="radio"/>	C	D	43	A	B	<input checked="" type="radio"/>	D	68	A	B	<input checked="" type="radio"/>	D					
	19	A	B	C	<input checked="" type="radio"/>	44	A	B	<input checked="" type="radio"/>	D	69	A	B	C	<input checked="" type="radio"/>					
	20	<input checked="" type="radio"/>	B	C	D	45	A	B	C	<input checked="" type="radio"/>	70	A	B	C	<input checked="" type="radio"/>					
	21	A	B	C	<input checked="" type="radio"/>	46	A	<input checked="" type="radio"/>	C	D	71	A	B	<input checked="" type="radio"/>	D					
	22	A	B	C	<input checked="" type="radio"/>	47	A	B	<input checked="" type="radio"/>	D	72	A	B	C	<input checked="" type="radio"/>					
	23	A	B	C	<input checked="" type="radio"/>	48	A	B	<input checked="" type="radio"/>	D	73	<input checked="" type="radio"/>	B	C	D					
	24	A	B	<input checked="" type="radio"/>	D	49	A	<input checked="" type="radio"/>	C	D	74	A	<input checked="" type="radio"/>	C	D					
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Objective Answer Sheet Booklet No.

(10 points)

ANSWER 2	Item	Select one									
	91	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input checked="" type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J
	92	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input checked="" type="radio"/> I	<input type="radio"/> J
	93	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input checked="" type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J
	94	<input type="radio"/> A	<input type="radio"/> B	<input checked="" type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J
	95	<input type="radio"/> A	<input type="radio"/> B	<input checked="" type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J
	96	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input checked="" type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J
	97	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J
	98	<input checked="" type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J
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104	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input checked="" type="radio"/> J	
105	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input checked="" type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	

(10 points)

ANSWER 3	Item	Review		Compilation		
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	107	<input checked="" type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input checked="" type="radio"/> E
	108	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input checked="" type="radio"/> E
	109	<input checked="" type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input checked="" type="radio"/> D	<input type="radio"/> E
	110	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input checked="" type="radio"/> E
	111	<input checked="" type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input checked="" type="radio"/> E
	112	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input checked="" type="radio"/> E
	113	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input checked="" type="radio"/> E
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116	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input checked="" type="radio"/> E	
117	<input checked="" type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input checked="" type="radio"/> E	
118	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input checked="" type="radio"/> E	
119	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input checked="" type="radio"/> E	
120	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input checked="" type="radio"/> E	

Answer sheet has been modified from original scan sheet.

Answer 4 (10 points)

a. Management fraud is the deliberate falsification or alteration of accounting records or documents committed by management to intentionally render the financial statements misleading. A defalcation is the misappropriation of an entity's assets by an employee through embezzlement, the falsification of documents, or violation of policy.

b. Under GAAS an auditor is responsible to assess the risk that management fraud may cause the financial statements to be materially misstated. Based on that assessment, the auditor should design the audit to provide reasonable assurance of detecting management fraud that is material to the financial statements.

c. The characteristics of management fraud that an auditor should consider include the materiality of the effect on the financial statements, the level of management involved, the extent and skillfulness of any concealment, the relationship to established control procedures, and the specific financial statements affected.

d. Among the other factors that should heighten an auditor's concern about the existence of management fraud are the following:

- Potential sale of the entity.
- Undertaking an aggressive acquisition program using the entity's stock as consideration.
- Indications that the entity will fall short of meeting earnings or sales forecasts.
- Indications of financial distress such as insufficient working capital, high debt, slow collection of receivables, or other going concern problems.
- Unfavorable industry conditions.
- The existence of related party transactions.
- A CEO who dominates the board of directors.

Answer 5 (10 points)

a. Financial statement assertions are representations by management that are embodied in financial statement components.


b. In obtaining evidential matter in support of financial statement assertions, an auditor develops specific audit objectives in the light of those assertions.

c. In developing the audit objectives of a particular engagement, an auditor should consider the specific circumstances of the entity, including the nature of its economic activity and the accounting practices unique to its industry.

d. There is not necessarily a one-to-one relationship between audit objectives and procedures. Some auditing procedures may relate to more than one objective. On the other hand, a combination of auditing procedures may be needed to achieve a single objective. The procedures adopted should be adequate to achieve the audit objectives.

e. In selecting particular substantive tests to achieve audit objectives, an auditor considers, among other things, the risk of material misstatement in the financial statements, including the assessed levels of control risk, and the expected effectiveness and efficiency of such tests. An auditor's considerations also include the nature and materiality of the items being tested, the kinds and competence of available evidential matter, and the nature of the audit objective to be achieved.

O B J E C T I V E A N S W E R S H E E T

- Record your 7-digit candidate number in the boxes on the right, then **blacken completely the oval for each digit you have recorded.**
- Use a Number 2 pencil. 
- Erase clearly any marks you wish to change. **Make no stray marks on this sheet.**

INCORRECT MARKS CORRECT MARK

CANDIDATE NUMBER

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1	1	1	1	1	1
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Print your **STATE** name here.

UNIFORM CERTIFIED PUBLIC ACCOUNTANT EXAMINATION

Accounting & Reporting—Taxation, Managerial, and Governmental and Not-for-Profit Organizations

ARE

VERSION 1

For Proctor Use Only

November 2, 1995; 8:30 A.M. to 12:00 NOON

(60 points)

Objective Answer Sheets may vary from examination to examination. Be certain that your answer corresponds directly in number with the examination item.

ANSWER 1	1 (A) (B) ● (D)	21 (A) (B) ● (D)	41 (A) (B) ● (D)	61 ● (B) (C) (D)
	2 (A) (B) (C) ●	22 ● (B) (C) (D)	42 (A) (B) (C) ●	62 (A) (B) (C) ●
	3 (A) ● (C) (D)	23 ● (B) (C) (D)	43 (A) ● (C) (D)	63 (A) ● (C) (D)
	4 (A) (B) (C) ●	24 (A) ● (C) (D)	44 (A) ● (C) (D)	64 ● (B) (C) (D)
	5 (A) (B) ● (D)	25 (A) ● (C) (D)	45 ● (B) (C) (D)	65 (A) (B) ● (D)
	6 (A) (B) ● (D)	26 (A) (B) (C) ●	46 (A) (B) ● (D)	66 (A) (B) (C) ●
	7 (A) (B) (C) ●	27 (A) ● (C) (D)	47 (A) ● (C) (D)	67 ● (B) (C) (D)
	8 (A) ● (C) (D)	28 (A) (B) (C) ●	48 (A) (B) ● (D)	68 (A) (B) ● (D)
	9 (A) (B) ● (D)	29 ● (B) (C) (D)	49 (A) (B) ● (D)	69 (A) ● (C) (D)
	10 (A) ● (C) (D)	30 ● (B) (C) (D)	50 (A) (B) (C) ●	70 (A) (B) ● (D)
	11 ● (B) (C) (D)	31 (A) ● (C) (D)	51 ● (B) (C) (D)	71 (A) (B) (C) ●
	12 ● (B) (C) (D)	32 (A) (B) (C) ●	52 ● (B) (C) (D)	72 (A) (B) ● (D)
	13 (A) (B) (C) ●	33 (A) ● (C) (D)	53 (A) ● (C) (D)	73 (A) ● (C) (D)
	14 (A) (B) ● (D)	34 (A) (B) ● (D)	54 (A) (B) ● (D)	74 ● (B) (C) (D)
	15 ● (B) (C) (D)	35 (A) (B) ● (D)	55 ● (B) (C) (D)	75 (A) ● (C) (D)
	16 (A) (B) (C) ●	36 (A) (B) ● (D)	56 (A) (B) (C) ●	
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	19 (A) (B) ● (D)	39 (A) (B) ● (D)	59 ● (B) (C) (D)	
	20 (A) (B) ● (D)	40 (A) (B) ● (D)	60 (A) (B) ● (D)	

(5 points)

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Objective Answer Sheet Booklet No.

UNIFORM CERTIFIED PUBLIC ACCOUNTANT EXAMINATION

Accounting & Reporting—Taxation, Managerial, and Governmental and Not-for-Profit Organizations

ARE
VERSION 1

For Question Numbers 2, 3a, 3b, and 5, you may write the numbers in the boxes provided to facilitate blackening the ovals; however, the numbers written in the boxes will **not** be graded. Zeros have already been preprinted for some of the columns.

(20 points)

ANSWER 3

a. 82	83	84	85	86	87	88
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89	90	91	b. 92			
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c.

Item	Select one										
93	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	99	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
94	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	100	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
95	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	101	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
96	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	102	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
97	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	103	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
98	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	104	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D

d.

Item	Select one	
105	<input type="radio"/> A	<input type="radio"/> B
106	<input type="radio"/> A	<input type="radio"/> B
107	<input type="radio"/> A	<input type="radio"/> B
108	<input type="radio"/> A	<input type="radio"/> B
109	<input type="radio"/> A	<input type="radio"/> B
110	<input type="radio"/> A	<input type="radio"/> B

(5 points)

ANSWER 4




Item	Select one									
111	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	114	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
112	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	115	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D
113	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	116	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D

(10 points)

ANSWER 5

117	118	119	120	121
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122	123	124	125	126
1 0 4,5 0 0	3 8 6,0 0 0	1 0 0,0 0 0	1 8 1,0 0 0	1 9 0,0 0 0
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O B J E C T I V E A N S W E R S H E E T

- Record your 7-digit candidate number in the boxes on the right, then blacken completely the oval for each digit you have recorded.
 - Use a Number 2 pencil. 
 - Erase clearly any marks you wish to change. **Make no stray marks on this sheet.**
- INCORRECT MARKS CORRECT MARK
 

CANDIDATE NUMBER						
0	1	2	3	4	5	6
7	8	9	0	1	2	3
4	5	6	7	8	9	0
1	2	3	4	5	6	7
8	9	0	1	2	3	4
5	6	7	8	9	0	1
2	3	4	5	6	7	8
9	0	1	2	3	4	5
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8	9	0	1	2	3	4
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3	4	5	6	7	8	9
4	5	6	7	8	9	0
5	6	7	8	9	0	1
6	7					

(10 points)

Item	Select one
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62	<input checked="" type="radio"/> B <input type="radio"/> D <input type="radio"/> A
63	<input type="radio"/> H <input type="radio"/> D <input checked="" type="radio"/> C
64	<input type="radio"/> H <input type="radio"/> D <input checked="" type="radio"/> C

Item	Select one
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66	<input type="radio"/> A <input type="radio"/> B <input type="radio"/> C <input type="radio"/> D <input type="radio"/> E <input type="radio"/> F <input type="radio"/> G <input type="radio"/> H <input checked="" type="radio"/> I <input type="radio"/> J <input type="radio"/> K
67	<input type="radio"/> A <input type="radio"/> B <input type="radio"/> C <input type="radio"/> D <input type="radio"/> E <input type="radio"/> F <input type="radio"/> G <input type="radio"/> H <input type="radio"/> I <input checked="" type="radio"/> J <input type="radio"/> K

Item	Select one	Select one
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69	<input type="radio"/> A <input checked="" type="radio"/> B <input type="radio"/> C <input type="radio"/> D <input type="radio"/> E <input type="radio"/> F <input type="radio"/> G <input type="radio"/> H <input type="radio"/> I <input type="radio"/> J <input type="radio"/> K	<input type="radio"/> G <input checked="" type="radio"/> H
70	<input type="radio"/> A <input type="radio"/> B <input checked="" type="radio"/> C <input type="radio"/> D <input type="radio"/> E <input type="radio"/> F <input type="radio"/> G <input type="radio"/> H <input type="radio"/> I <input type="radio"/> J <input type="radio"/> K	<input type="radio"/> G <input checked="" type="radio"/> H

(10 points)

Item	Rate	Amount
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72	<input type="radio"/> A <input type="radio"/> B <input type="radio"/> C <input type="radio"/> D <input type="radio"/> E <input type="radio"/> F	<input type="radio"/> G <input type="radio"/> H <input type="radio"/> I <input checked="" type="radio"/> J <input type="radio"/> K <input type="radio"/> L <input type="radio"/> M <input type="radio"/> N <input type="radio"/> O <input type="radio"/> P <input type="radio"/> Q <input type="radio"/> R <input type="radio"/> S <input type="radio"/> T <input type="radio"/> U <input type="radio"/> V <input type="radio"/> W <input type="radio"/> X
73	<input type="radio"/> A <input type="radio"/> B <input type="radio"/> C <input type="radio"/> D <input type="radio"/> E <input type="radio"/> F	<input type="radio"/> G <input type="radio"/> H <input type="radio"/> I <input type="radio"/> J <input type="radio"/> K <input type="radio"/> L <input type="radio"/> M <input type="radio"/> N <input type="radio"/> O <input type="radio"/> P <input type="radio"/> Q <input type="radio"/> R <input checked="" type="radio"/> S <input type="radio"/> T <input type="radio"/> U <input type="radio"/> V <input type="radio"/> W <input type="radio"/> X
74	<input type="radio"/> A <input type="radio"/> B <input type="radio"/> C <input checked="" type="radio"/> D <input type="radio"/> E <input type="radio"/> F	<input type="radio"/> G <input type="radio"/> H <input type="radio"/> I <input type="radio"/> J <input type="radio"/> K <input type="radio"/> L <input type="radio"/> M <input type="radio"/> N <input type="radio"/> O <input type="radio"/> P <input type="radio"/> Q <input type="radio"/> R <input type="radio"/> S <input type="radio"/> T <input type="radio"/> U <input type="radio"/> V <input type="radio"/> W <input type="radio"/> X
75	<input type="radio"/> A <input type="radio"/> B <input type="radio"/> C <input type="radio"/> D <input type="radio"/> E <input checked="" type="radio"/> F	<input type="radio"/> G <input type="radio"/> H <input type="radio"/> I <input type="radio"/> J <input type="radio"/> K <input type="radio"/> L <input type="radio"/> M <input type="radio"/> N <input type="radio"/> O <input type="radio"/> P <input type="radio"/> Q <input type="radio"/> R <input type="radio"/> S <input type="radio"/> T <input type="radio"/> U <input type="radio"/> V <input type="radio"/> W <input type="radio"/> X
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77	<input type="radio"/> A <input type="radio"/> B <input type="radio"/> C <input type="radio"/> D <input type="radio"/> E <input type="radio"/> F	<input type="radio"/> G <input checked="" type="radio"/> H <input type="radio"/> I <input type="radio"/> J <input type="radio"/> K <input type="radio"/> L <input type="radio"/> M <input type="radio"/> N <input type="radio"/> O <input type="radio"/> P <input type="radio"/> Q <input type="radio"/> R <input type="radio"/> S <input type="radio"/> T <input type="radio"/> U <input type="radio"/> V <input type="radio"/> W <input type="radio"/> X

Item	Select one
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79	<input type="radio"/> D <input type="radio"/> A <input type="radio"/> B <input checked="" type="radio"/> N
80	<input type="radio"/> D <input type="radio"/> A <input type="radio"/> B <input checked="" type="radio"/> N
81	<input checked="" type="radio"/> D <input type="radio"/> A <input type="radio"/> B <input type="radio"/> N
82	<input type="radio"/> D <input type="radio"/> A <input checked="" type="radio"/> B <input type="radio"/> N
83	<input checked="" type="radio"/> D <input type="radio"/> A <input type="radio"/> B <input type="radio"/> N

Answer 4 (10 points)

a.

Baron Flowers
WORKSHEET TO CONVERT TRIAL BALANCE TO ACCRUAL BASIS
December 31, 1994

Account title	Cash basis		Adjustments		Accrual Basis*	
	Dr.	Cr.	Dr.	Cr.	Dr.*	Cr.*
Cash	25,600				25,600	
Accounts receivable	16,200		(1) 15,800		32,000	
Inventory	62,000		(4) 10,800		72,800	
Furniture & fixtures	118,200				118,200	
Land improvements	45,000				45,000	
Accumulated depreciation & amortization		32,400		(6) 14,250		46,650
Accounts payable		17,000		(3) 13,500		30,500
Baron, Drawings			(9) 61,000		61,000	
Baron, Capital		124,600	(7) 2,000	(5) 2,600		125,200
Allowance for uncollectible accounts				(2) 3,800		3,800
Prepaid insurance			(5) 2,900		2,900	
Accrued expenses				(7) 3,100		3,100
Estimated liability from lawsuit				(8) 50,000		50,000
Sales		653,000		(1) 15,800		668,800
Purchases	305,100		(3) 13,500		318,600	
Salaries	174,000			(9) 48,000	126,000	
Payroll taxes	12,400		(7) 500		12,900	
Insurance	8,700			(5) 300	8,400	
Rent	34,200				34,200	
Utilities	12,600		(7) 600		13,200	
Living expenses	13,000			(9) 13,000		
Income summary—inventory			(4) 62,000	(4) 72,800		10,800
Uncollectible accounts			(2) 3,800		3,800	
Depreciation & amortization			(6) 14,250		14,250	
Estimated loss from lawsuit			(8) 50,000		50,000	
	827,000	827,000	237,150	237,150	938,850	938,850

* Completion of these columns was not required.

Financial Accounting & Reporting — Business Enterprises

Answer 4 (continued)

Explanations of Adjustments

[1] To convert 1994 sales to accrual basis.

Accounts receivable balances:	
December 31, 1994	\$32,000
December 31, 1993	16,200
Increase in sales	<u>\$15,800</u>

[2] To record provision for uncollectible accounts.

[3] To convert 1994 purchases to accrual basis.

Accounts payable balances:	
December 31, 1994	\$30,500
December 31, 1993	17,000
Increase in purchases	<u>\$13,500</u>

[4] To record increase in inventory from 12/31/93 to 12/31/94.

Inventory balances:	
December 31, 1994	\$72,800
December 31, 1993	62,000
Increase in inventory	<u>\$10,800</u>

[5] To adjust prepaid insurance.

Prepaid balances:	
December 31, 1994 ($\$8,700 \times \frac{1}{12}$)	\$2,900
December 31, 1993 ($\$7,800 \times \frac{1}{12}$)	2,600
Decrease in insurance expense	<u>\$ 300</u>

[6] To record 1994 depreciation and amortization expense.

Cost of leasehold improvement	\$45,000
Estimated life	15 years
Amortization ($\$45,000 \times \frac{1}{15} \times \frac{1}{12}$)	2,250
Depreciation expense on fixtures and equipment	12,000
	<u>\$14,250</u>

[7] To convert expenses to accrual basis.

	<u>Balances</u>		<u>Increase in expenses</u>
	<u>December 31, 1994</u>	<u>1993</u>	
Utilities	\$1,500	\$ 900	\$ 600
Payroll taxes	1,600	1,100	500
	<u>\$3,100</u>	<u>\$2,000</u>	<u>\$1,100</u>

[8] To record lawsuit liability at 12/31/94.

Attorney's estimate of probable loss	\$300,000
Amount covered by insurance	250,000
Baron's estimated liability	<u>\$ 50,000</u>

[9] To record Baron's drawings for 1994.

Salary ($\$4,000 \times 12$)	\$48,000
Living expenses	13,000
	<u>\$61,000</u>

b.

To: Baron Flowers

From: Muir

Re: Accrual basis financial statements

You have asked me to explain why the bank would require financial statements prepared on the accrual basis instead of the cash basis. The bank is concerned about your ability to repay the loan. To assess that ability, it wants information about your earnings for the period, total assets, and all claims on those assets. This information about your enterprise's performance and financial position is provided more completely by accrual basis financial statements than by cash-basis financial statements.

Under the cash basis, revenues are recognized when received and expenses when paid. Earnings can be manipulated by the timing of cash receipts and disbursements. Accrual basis accounting, while grounded in cash flows, reports transactions and other events with cash consequences at the time the transactions and events occur. Revenues and expenses are reported in the accounting period benefited and reflect receivables and payables, not just what the enterprise was able to collect or chose to pay.

Answer 5 (10 points)

a. 1. The main characteristics of intangible assets are their lack of physical substance, the difficulty of estimating their value, and the high degree of uncertainty regarding their future life. Accounting for intangible assets depends on whether they have been purchased or developed internally.

Intangible assets purchased from others should be recorded at cost. The costs of developing intangible assets with indeterminable lives, such as goodwill, are ordinarily not distinguishable from the current costs of operations and thus are not assignable to specific assets but are expensed immediately.

2. Intangible assets should be amortized over their estimated useful life. Estimated useful life should be determined by consideration of such factors as legal life; provisions for renewal or extensions of contracts; the effects of obsolescence, demand, and competition; and other economic factors.

An apparently unlimited useful life may in fact be indefinite. The justification for amortizing the cost of goodwill or other intangible assets with an indeterminate life over time is that the value almost inevitably becomes zero at some future date. Since the date at which the value becomes zero is indeterminable, the useful life has been set arbitrarily at a period not to exceed forty years.

3. The financial statements should disclose the method and period of amortization of all intangible assets.

b.

Broca Co.
INTANGIBLES SECTION OF BALANCE SHEET
December 31, 1994

Goodwill, net of accumulated amortization of \$4,700	\$183,300	[1]
Franchise, net of accumulated amortization of \$12,000	48,000	[2]
Patent, net of accumulated amortization of \$13,600	122,400	[3]

[1]	Cash paid	\$360,000
	Value of net assets	(172,000)
	Goodwill	188,000
	Amortization over 40 years	(4,700)
	Balance	<u>\$183,300</u>

[2]	Franchise	\$60,000
	Amortization over 5 years	(12,000)
	Balance	<u>\$48,000</u>

[3]	Legal costs (51,000 + 85,000)	\$136,000
	Amortization over 10 years	(13,600)
	Balance	<u>\$122,400</u>

EXPENSES RESULTING FROM INTANGIBLES
For the Year Ended December 31, 1994

Amortization:	
Goodwill	\$ 4,700
Franchise	12,000
Patent	13,600
	<u>\$30,300</u>
Franchise fee	200
	<u>\$30,500</u>

SUGGESTED REFERENCES

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- Clarkson, Miller, Jentz, & Cross, *West's Business Law*, 6th ed. (West, 1995).
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- Miller & Jentz, *Business Law Today*, 3d ed. (West, 1994).
- Schantz & Jackson, *Business Law*, 2d ed. (West, 1987).
- Uniform Commercial Code—Negotiable Instruments Article; Sales Article; Secured Transactions Article.
- Uniform Partnership Act.

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Auditing

- AICPA, *Audit and Accounting Guide, Audit Sampling* (AICPA, 1992).
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- General Accounting Office, *Government Auditing Standards* (U.S. Government Printing Office, 1994).
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- Robertson, *Auditing*, 7th ed. (Irwin, 1993).
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- Watne and Turney, *Auditing EDP Systems*, 2d ed. (Prentice-Hall, 1990).
- Whittington and Pany, *Principles of Auditing*, 11th ed. (Irwin, 1995).

Suggested References

**Accounting & Reporting—Taxation, Managerial,
and Governmental and Not-for-Profit Organizations**

- AICPA, Audit and Accounting Guide, *Audits of Providers of Health Care Services* (AICPA, 1994).
- AICPA, Audit and Accounting Guide, *Audits of State and Local Governmental Units* (AICPA, 1994).
- AICPA, Industry Audit Guide, *Audits of Colleges and Universities* (AICPA, 1994).
- Federal Tax Course 1994 (Commerce Clearing House).
- GASB, *Codification of Governmental Accounting and Financial Reporting Standards* (GASB).
- Hammer, Carter and Usry, *Cost Accounting: Planning and Control*, 11th ed. (South-Western, 1994).
- Hay and Wilson, *Accounting for Governmental and Nonprofit Entities*, 10th ed. (Irwin, 1995).
- Hirsch, *Advanced Management Accounting*, 2nd ed. (South-Western, 1994).
- Maher and Deakin, *Cost Accounting*, 4th ed. (Irwin, 1994).
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- Rayburn, *Cost Accounting: Using a Cost Management Approach*, 5th ed. (Irwin, 1993).
- U.S. Master Tax Guide (Commerce Clearing House).
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Financial Accounting & Reporting — Business Enterprises

- AICPA, *Personal Financial Statements Guide* (AICPA, 1991).
- AICPA, *Technical Practice Aids* (AICPA, 1993).
- Boatsman, Griffen, Vickrey, and Williams, *Advanced Accounting*, 7th ed. (Irwin, 1994).
- Chasteen, Flaherty, and O'Connor, *Intermediate Accounting*, 5th ed. (McGraw Hill, 1995).
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INDEX – QUESTIONS

HOW TO USE THIS INDEX: This index presents examination question number references for the four sections of the CPA Examination – Business Law & Professional Responsibilities, Auditing, Accounting & Reporting– Taxation, Managerial, and Governmental and Not-for-Profit Organizations, and Financial Accounting & Reporting – Business Enterprises. Each examination section has been organized according to its content specification outline, with questions indexed according to the areas and groups tested.

The question references listed in the right-hand column are designated as follows: The letter M following question numbers indicates a multiple-choice item. For example, the reference 17M means multiple-choice item number 17. Absence of the letter M indicates an other objective answer format or essay question.

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Payment enclosed MasterCard Visa

CARD ACCOUNT NUMBER

□ □ □ □ □ □ □ □ □ □ □ □ □ □ □ □

Exp. date ____ / ____ / ____

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Telephone No. _____

Signature _____

Cardholder Address _____

City _____ State _____ Zip _____

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