1984

Uniform CPA examination questions May 1982 to November 1983

American Institute of Certified Public Accountants. Board of Examiners

Uniform CPA Examination

May 1982 to November 1983

Questions

AICPA

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Certified Public Accountants

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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. The examinations and unofficial answers are published twice a year, shortly after the May and the November examination dates.

Responding to continuing demand, we continue to publish a two volume set containing two years of examinations — May 1982 through November 1983. Questions and unofficial answers appear in separate volumes, which are published simultaneously.

Although the questions and unofficial answers may be used for many purposes, the principal reason for their publication is to aid candidates in their preparation. Candidates are also encouraged to read *Information for CPA 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.

A special note of thanks is extended to John G. Pate, Jr., University of Texas at El Paso, for preparing the index included in this volume.

William C. Bruschi, *Vice President-Examinations and Regulation*
American Institute of Certified Public Accountants

March 1984

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Uniform Certified Public Accountant Examination

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN ACCOUNTING PRACTICE — PART I

May 5, 1982; 1:30 to 6:00 P.M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	Estimated Minutes Minimum	Estimated Minutes Maximum
No. 1	45	55
No. 2	45	55
No. 3	45	55
No. 4	45	55
No. 5	40	50
Total	220	270

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers. Since objective items are computer graded, your comments and calculations associated with them are not considered.

3. For problem-type questions you should enclose all scratch sheets. Failure to enclose scratch sheets may result in loss of grading points. Scratch sheets need not have page numbers, but you should show the question number and place them immediately following the question to which they relate.

4. Fourteen-column sheets, if any, should not be folded until all sheets, both wide and narrow, are placed in the proper sequence and fastened together at the top left corner. All fourteen-column sheets should then be wrapped around the back of the papers.

5. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of financial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on your total correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

97. Gross billings for merchandise sold by Baker Company to its customers last year amounted to $5,260,000; sales returns and allowances reduced the amounts owed by $160,000. How much were net sales last year for Baker Company?

a. $4,800,000
b. $5,100,000
c. $5,200,000
d. $5,260,000

Answer Sheet

97. ⓐ ● ⓒ ⓓ

Items to be Answered

1. On January 1, 1979, Miller Company purchased for $275,000 a machine with an estimated useful life of 10 years and no salvage value. The machine was depreciated using the sum-of-the-years'-digits method. On January 1, 1980, Miller changed to the straight-line method of depreciation. Miller can justify the change. What should be the depreciation expense on this machine for the year ended December 31, 1981?

a. $18,000
b. $22,500
c. $25,000
d. $27,500

2. Wright Company bought a building on July 1, 1979, for $130,000. A fire insurance policy with a face amount of $100,000 and a coinsurance clause of 80% was taken out on the building. On February 2, 1982, the building was partially destroyed by fire and the loss was estimated at $120,000. Assuming that the fair market value of the building was $180,000 at the date of the fire, how much should Wright expect to recover from the insurance company?

a. $ 80,000
b. $ 83,333
c. $ 96,000
d. $100,000

3. Tillary Company, which began business on January 1, 1981, appropriately uses the installment sales method of accounting. The following data are available for 1981:

Installment accounts receivable, December 31, 1981	$200,000
Deferred gross profit, December 31, 1981 (before recognition of realized gross profit)	$140,000
Gross profit on sales	40%

The cash collections and the realized gross profit on installment sales for the year ended December 31, 1981, should be

	Cash collections	*Realized gross profit*
a.	$100,000	$80,000
b.	$100,000	$60,000
c.	$150,000	$80,000
d.	$150,000	$60,000

4. Based upon its past collection experience, Alden Company provides for bad debt expense at the rate of 2% of credit sales. On January 1, 1981, the allowance for doubtful accounts balance was $10,000. During 1981 Alden wrote off $18,000 of uncollectible receivables and recovered $5,000 of bad debts written off in prior years. If credit sales for 1981 totaled $1,000,000, the allowance for doubtful accounts balance at December 31, 1981, should be

a. $12,000
b. $17,000
c. $20,000
d. $30,000

5. Georgia, Inc., has an authorized capital of 1,000 shares of $100 par, 8% cumulative preferred stock and 100,000 shares of $10 par common stock. The equity account balances at December 31, 1981, are as follows:

Cumulative preferred stock	$ 50,000
Common stock	90,000
Additional paid-in capital	9,000
Retained earnings	13,000
Treasury stock, common — 100 shares at cost	(2,000)
	$160,000

Dividends on preferred stock are in arrears for the year 1981. The book value of a share of common stock, at December 31, 1981, should be

a. $11.78
b. $11.91
c. $12.22
d. $12.36

6. In preparing its bank reconciliation for the month of March 1982, Derby Company has available the following information:

Balance per bank statement, 3/31/82	$36,050
Deposit in transit, 3/31/82	6,250
Outstanding checks, 3/31/82	5,750
Credit erroneously recorded by bank in Derby's account, 3/12/82	250
Bank service charges for March	50

What should be the correct balance of cash at March 31, 1982?
a. $35,250
b. $36,250
c. $36,300
d. $36,550

7. Marshall Company prepared an aging of its accounts receivable at December 31, 1981, and determined that the net realizable value of the receivables at that date is $50,000. Additional information is available as follows:

Accounts receivable at December 31, 1980	$48,000
Accounts receivable at December 31, 1981	54,000
Allowance for doubtful accounts at December 31, 1980 — credit balance	6,000
Accounts written off as uncollectible during 1981	5,000

Marshall's bad debt expense for the year ended December 31, 1981, was
a. $3,000
b. $4,000
c. $5,000
d. $7,000

8. Bond Company leased equipment from Howe, Inc., on December 31, 1980, for a ten-year period (the useful life of the asset) expiring December 30, 1990. Equal annual payments under the lease are $100,000 and are due on December 31 of each year. The first payment was made on December 31, 1980, and the second payment was made on the due date. The present value at December 31, 1980, of the minimum lease payments over the lease term discounted at 10% (the implicit rate computed by Howe and known by Bond) was $676,000. Bond's incremental borrowing rate was 12% at December 31, 1980. The lease is appropriately accounted for as a capital lease by Bond. What should be the balance in Bond's liability under capital lease account at December 31, 1981?
a. $533,600
b. $545,120
c. $607,960
d. $800,000

9. In January 1980 Colonial Company purchased equipment for $120,000, to be used in its manufacturing operations. The equipment was estimated to have a useful life of 8 years, with salvage value estimated at $12,000. Colonial considered various methods of depreciation and selected the sum-of-the-years'-digits method. On December 31, 1981, the related allowance for accumulated depreciation should have a balance
a. $15,000 less than under the straight-line method.
b. $15,000 less than under the double declining balance method.
c. $18,000 greater than under the straight-line method.
d. $18,000 greater than under the double declining balance method.

10. On January 1, 1982, Robert Harrison signed an agreement to operate as a franchisee of Perfect Pizza, Inc., for an initial franchise fee of $40,000. Of this amount, $15,000 was paid when the agreement was signed and the balance is payable in five annual payments of $5,000 each beginning January 1, 1983. The agreement provides that the down payment is not refundable and no future services are required of the franchisor. Harrison's credit rating indicates that he can borrow money at 12% for a loan of this type. Information on present and future value factors is as follows:

Present value of $1 at 12% for 5 periods	.567
Future amount of $1 at 12% for 5 periods	1.762
Present value of an ordinary annuity of $1 at 12% for 5 periods	3.605

Harrison should record the acquisition cost of the franchise on January 1, 1982, at
a. $29,175
b. $33,025
c. $40,000
d. $44,050

11. At December 31, 1980, Welsch, Inc., had 500,000 shares of common stock outstanding. On October 1, 1981, an additional 120,000 shares of common stock were issued for cash. Welsch also had $4,000,000 of 8% convertible bonds outstanding at December 31, 1981, which are convertible into 100,000 shares of common stock. The bonds were considered common stock equivalents at the time of issuance and are dilutive in the 1981 earnings per share computation. No bonds were issued or converted into common stock during 1981. What is the number of shares that should be used in computing primary earnings per share for the year ended December 31, 1981?
a. 530,000
b. 600,000
c. 630,000
d. 720,000

12. On July 1, 1981, Stone Corporation received a condemnation award of $300,000 as compensation for the forced sale of a plant located on company property which stood in the path of a new highway. On this date the plant building had a depreciated cost of $150,000 and the land cost was $50,000. On October 1, 1981, Stone purchased a parcel of land for a new plant site at a cost of $125,000. Ignoring income taxes, Stone should report on its income statement for the year ended December 31, 1981, a gain of

a. $0
b. $ 25,000
c. $ 75,000
d. $100,000

13. The following information is available for Cooke Company for 1981:

Net sales	$1,800,000
Freight-in	45,000
Purchase discounts	25,000
Ending inventory	120,000

The gross margin is 40% of net sales. What is the cost of goods available for sale?

a. $ 840,000
b. $ 960,000
c. $1,200,000
d. $1,220,000

14. On January 1, 1981, Dorr Company borrowed $200,000 from its major customer, Pine Corporation, evidenced by a note payable in three years. The promissory note did not bear interest. Dorr agreed to supply Pine's inventory needs for the loan period at favorable prices. The going rate of interest for this type of loan is 14%. Assume that the present value (at the going rate of interest) of the $200,000 note is $135,000 at January 1, 1981. What amount of interest expense should be included in Dorr's 1981 income statement?

a. $0
b. $18,900
c. $21,667
d. $28,000

15. For calendar year 1981 Steiner Corporation reported depreciation of $300,000 in its income statement. On its 1981 income tax return Steiner reported depreciation of $500,000. Additionally, Steiner's income statement included interest income of $50,000 on municipal obligations. Assuming an income tax rate of 40%, the amount of deferred taxes reported on Steiner's 1981 income statement should be

a. $ 60,000
b. $ 80,000
c. $100,000
d. $120,000

Items 16 and 17 are based on the following information:

Tudor Corporation's condensed financial statements provide the following information:

Balance Sheet
December 31, 1981 and 1980

	1981	*1980*
Cash	$ 60,000	$ 50,000
Accounts receivable (net)	220,000	200,000
Inventories	260,000	230,000
Property, plant and equipment	730,000	650,000
Accumulated depreciation	(330,000)	(260,000)
Total assets	$ 940,000	$ 870,000
Current liabilities	$ 270,000	$ 330,000
Stockholders' equity	670,000	540,000
Total liabilities and stockholders' equity	$ 940,000	$ 870,000

Statement of Income
For the Year Ended December 31, 1981

Net sales	$1,200,000
Cost of goods sold	780,000
Gross profit	420,000
Operating expenses	240,000
Net income	$ 180,000

16. Assuming that all sales are credit sales, what is Tudor's accounts receivable turnover ratio for 1981?

a. 3.18
b. 5.45
c. 5.71
d. 6.00

17. What is Tudor's rate of return on average assets for 1981?

a. 14.17%
b. 19.15%
c. 19.89%
d. 29.75%

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18. On January 1, 1981, Gray Company sold a building which cost $190,000 and had accumulated depreciation of $80,000 on the date of sale. Gray received as consideration a $200,000 noninterest bearing note due on January 1, 1984. There was no established exchange price for the building, and the note had no ready market. The prevailing rate of interest for a note of this type at January 1, 1981, was 10%. The present value of $1 at 10% for three periods is 0.75. What amount of interest income should be included in Gray's 1981 income statement?
   a. $ 6,750
   b. $15,000
   c. $16,667
   d. $20,000

19. Melville Company leased equipment from Rice Corporation on July 1, 1981, for an eight-year period expiring June 30, 1989. Equal payments under the lease are $600,000 and are due on July 1 of each year. The first payment was made on July 1, 1981. The rate of interest contemplated by Melville and Rice is 10%. The cash selling price of the equipment is $3,520,000 and the cost of the equipment on Rice's accounting records is $2,800,000. Assuming that the lease is appropriately recorded as a sales-type lease, what is the amount of profit on the sale and interest income that Rice should record for the year ended December 31, 1981?
   a. $0 and $0.
   b. $0 and $146,000.
   c. $720,000 and $146,000.
   d. $720,000 and $160,000.

20. In July 1977 Simpson Company filed suit in federal court against White Corporation seeking to recover $750,000 for patent infringement. A court verdict was rendered in August 1981 awarding Simpson $500,000 in damages. White has appealed the verdict but a final decision is not expected before October 1982. Simpson's counsel believes it is probable that Simpson will be successful against White for an estimated amount of $400,000. What amount should Simpson accrue by a credit to income in the year ended December 31, 1981?
   a. $0
   b. $400,000
   c. $500,000
   d. $750,000

Number 2 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of managerial accounting and quantitative methods problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on your total correct answers.

Items to be Answered

21. Hartwell Company distributes the service department overhead costs directly to producing departments without allocation to the other service department. Information for the month of January 1982 is as follows:

	Service departments	
	Maintenance	*Utilities*
Overhead costs incurred	$18,700	$9,000
Service provided to:		
Maintenance department	-	10%
Utilities department	20%	-
Producing department A	40%	30%
Producing department B	40%	60%
Total	100%	100%

The amount of utilities department costs distributed to producing department B for January 1982 should be
   a. $3,600
   b. $4,500
   c. $5,400
   d. $6,000

22. Martin Company uses a two-way analysis of overhead variances. Selected data for the April 1982 production activity are as follows:

Actual variable factory overhead incurred	$196,000
Variable factory overhead rate per direct-labor hour	$ 6.00
Standard direct-labor hours allowed	33,000
Actual direct-labor hours	32,000

Assuming that budgeted fixed overhead costs are equal to actual fixed costs, the budget (controllable) variance for April 1982 is
   a. $2,000 favorable.
   b. $4,000 unfavorable.
   c. $4,000 favorable.
   d. $6,000 favorable.

23. Worrell Corporation has a job order cost system. The following debits (credits) appeared in the general ledger account work-in-process for the month of March 1982:

March 1, balance	$ 12,000
March 31, direct materials	40,000
March 31, direct labor	30,000
March 31, factory overhead	27,000
March 31, to finished goods	(100,000)

Worrell applies overhead to production at a predetermined rate of 90% based on the direct-labor cost. Job No. 232, the only job still in process at the end of March 1982, has been charged with factory overhead of $2,250. What was the amount of direct materials charged to Job No. 232?

a. $2,250
b. $2,500
c. $4,250
d. $9,000

24. Wagner Company sells product A at a selling price of $21 per unit. Wagner's cost per unit based on the full capacity of 200,000 units is as follows:

Direct materials	$ 4
Direct labor	5
Overhead (two-thirds of which is fixed)	6
	$15

A special order offering to buy 20,000 units was received from a foreign distributor. The only selling costs that would be incurred on this order would be $3 per unit for shipping. Wagner has sufficient existing capacity to manufacture the additional units. In negotiating a price for the special order, Wagner should consider that the minimum selling price per unit should be

a. $14
b. $15
c. $16
d. $18

25. Information on Hanley's direct-labor costs for the month of January 1982 is as follows:

Actual direct-labor rate	$ 7.50
Standard direct-labor hours allowed	11,000
Actual direct-labor hours	10,000
Direct-labor rate variance—favorable	$ 5,500

What was the standard direct-labor rate in effect for the month of January 1982?

a. $6.95
b. $7.00
c. $8.00
d. $8.05

26. Information for the month of January 1982 concerning department A, the first stage of Ogden Corporation's production cycle, is as follows:

	Materials	Conversion
Work-in-process, beginning	$ 8,000	$ 6,000
Current costs	40,000	32,000
Total costs	$48,000	$38,000
Equivalent units using weighted-average method	100,000	95,000
Average unit costs	$ 0.48	$ 0.40
Goods completed		90,000 units
Work-in-process, end		10,000 units

Materials are added at the beginning of the process. The ending work-in-process is 50% complete as to conversion costs. How would the total costs accounted for be distributed, using the weighted-average method?

	Goods completed	*Work-in-process, end*
a.	$79,200	$6,800
b.	$79,200	$8,800
c.	$86,000	$0
d.	$88,000	$6,800

27. Under Heller Company's job order cost system, estimated costs of defective work (considered normal in the manufacturing process) are included in the predetermined factory overhead rate. During March 1982 Job No. 210 for 2,000 hand saws was completed at the following costs per unit:

Direct materials	$ 5
Direct labor	4
Factory overhead (applied at 150% of direct-labor cost)	6
	$15

Final inspection of Job No. 210 disclosed 100 defective saws which were reworked at a cost of $2 per unit for direct labor, plus overhead at the predetermined rate. The defective units on Job No. 210 fall within the normal range. What is the total rework cost and to what account should it be charged?

	Rework cost	*Account charged*
a.	$200	Work-in-process
b.	$200	Factory overhead control
c.	$500	Work-in-process
d.	$500	Factory overhead control

28. Richardson Company computed the flow of physical units completed for department M for the month of March 1982 as follows:

Units completed:	
From work-in-process on March 1, 1982	15,000
From March production	45,000
	60,000

Materials are added at the beginning of the process. The 12,000 units of work-in-process at March 31, 1982, were 80% complete as to conversion costs. The work-in-process at March 1, 1982, was 60% complete as to conversion costs. Using the FIFO method, the equivalent units for March conversion costs were

a. 55,200
b. 57,000
c. 60,600
d. 63,600

29. Tooker Company adds materials at the beginning of the process in department A. Information concerning the materials used in April 1982 production is as follows:

	Units
Work-in-process at April 1	10,000
Started during April	50,000
Completed and transferred to next department during April	36,000
Normal spoilage incurred	3,000
Abnormal spoilage incurred	5,000
Work-in-process at April 30	16,000

Under Tooker's cost accounting system, costs of normal spoilage are treated as a part of the costs of the good units produced. However, the costs of abnormal spoilage are charged to factory overhead. Using the weighted-average method, what are the equivalent units for the materials unit cost calculation for the month of April?

a. 47,000
b. 52,000
c. 55,000
d. 57,000

30. Gandy Company has 5,000 obsolete desk lamps that are carried in inventory at a manufacturing cost of $50,000. If the lamps are reworked for $20,000, they could be sold for $35,000. Alternatively, the lamps could be sold for $8,000 to a jobber located in a distant city. In a decision model analyzing these alternatives, the sunk cost would be

a. $ 8,000
b. $15,000
c. $20,000
d. $50,000

31. Buckler Company manufactures desks with vinyl tops. The standard material cost for the vinyl used per Model S desk is $27.00 based on twelve square feet of vinyl at a cost of $2.25 per square foot. A production run of 1,000 desks in March 1982 resulted in usage of 12,600 square feet of vinyl at a cost of $2.00 per square foot, a total cost of $25,200. The usage variance resulting from the above production run was

a. $1,200 unfavorable.
b. $1,350 unfavorable.
c. $1,800 favorable.
d. $3,150 favorable.

32. The gross profit of Reade Company for each of the years ended December 31, 1981 and 1980, was as follows:

	1981	*1980*
Sales	$792,000	$800,000
Cost of goods sold	464,000	480,000
Gross profit	$328,000	$320,000

Assuming that selling prices were 10% lower during 1981, what would be the amount of decrease in gross profit due to the change in selling prices?

a. $ 8,000
b. $72,000
c. $79,200
d. $88,000

33. Kern Company prepared the following tentative forecast concerning product A for 1982:

Sales	$500,000
Selling price per unit	$ 5.00
Variable costs	$300,000
Fixed costs	$150,000

A study made by the sales manager disclosed that the unit selling price could be increased by 20%, with an expected volume decrease of only 10%. Assuming that Kern incorporates these changes in its 1982 forecast, what should be the operating income from product A?

a. $ 66,000
b. $ 90,000
c. $120,000
d. $145,000

34. Singer, Inc., sells product R for $5 per unit. The fixed costs are $210,000 and the variable costs are 60% of the selling price. What would be the amount of sales if Singer is to realize a profit of 10% of sales?

a. $700,000
b. $525,000
c. $472,500
d. $420,000

35. In planning its budget for 1982, King Company prepared the following payoff probability distribution describing the relative likelihood of monthly sales volume levels and related contribution margins for product A:

Monthly sales volume	*Contribution margin*	*Probability*
4,000	$ 80,000	.20
6,000	120,000	.25
8,000	160,000	.30
10,000	200,000	.15
12,000	240,000	.10

What is the expected value of the monthly contribution margin for product A?

a. $140,000
b. $148,000
c. $160,000
d. $180,000

36. Womark Company purchased a new machine on January 1, 1981, for $90,000 with an estimated useful life of five years and a salvage value of $10,000. The machine will be depreciated using the straight-line method. The machine is expected to produce cash flow from operations, net of income taxes, of $36,000 a year in each of the next five years. The payback period would be

a. 2.2 years.
b. 2.5 years.
c. 4.0 years.
d. 4.5 years.

37. On January 1, 1981, Studley Company purchased a new machine for $100,000 with an estimated useful life of five years and no salvage value. For book and tax purposes, the machine will be depreciated using the straight-line method and it is expected to produce annual cash flow from operations, before income taxes, of $40,000. Assume that Studley uses a time-adjusted rate of 12% and that its income tax rate will be 40% for all years. The present value of $1 at 12% for five periods is 0.57, and the present value of an ordinary annuity of $1 at 12% for five periods is 3.61. The net present value of the machine should be

a. $15,520 positive.
b. $15,520 negative.
c. $14,000 positive.
d. $13,680 negative.

38. Hamilton Company invested in a two-year project having an internal rate of return of 12%. The project is expected to produce cash flow from operations, net of income taxes, of $60,000 in the first year and $70,000 in the second year. The present value of $1 for one period at 12% is 0.893 and for two periods at 12% is 0.797. How much will the project cost?

a. $103,610
b. $109,370
c. $116,090
d. $122,510

Items 39 and 40 are based on the following information:

Information from Peterson Company's records for the year ended December 31, 1981, is available as follows:

Net sales	$1,400,000
Cost of goods manufactured:	
Variable	$ 630,000
Fixed	$ 315,000
Operating expenses:	
Variable	$ 98,000
Fixed	$ 140,000
Units manufactured	70,000
Units sold	60,000
Finished goods inventory, January 1, 1981	None

There were no work-in-process inventories at the beginning and end of 1981.

39. What would be Peterson's finished goods inventory cost at December 31, 1981, under the variable (direct) costing method?

a. $ 90,000
b. $104,000
c. $105,000
d. $135,000

40. Under the absorption costing method, Peterson's operating income for 1981 would be

a. $217,000
b. $307,000
c. $352,000
d. $374,500

Number 3 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **the federal income taxation of individuals.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. The answers should be based upon 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. Mark only one answer for each item. Answer all items.** Your grade will be based on your total correct answers.

Items to be Answered

41. James Harper, a self-employed individual, owned a truck driven exclusively for business use. The truck had an original cost of $8,000 and had an adjusted basis on December 31, 1980, of $3,600. On January 2, 1981, he traded it in for a new truck costing $10,000 and was given a trade-in allowance of $2,000. The new truck will also be used exclusively for business purposes and will be depreciated with no salvage value. The basis of the new truck is

   a. $ 8,000
   b. $ 8,400
   c. $10,000
   d. $11,600

42. On July 1, 1978, William Greene paid $45,000 for 450 shares of Acme Corporation common stock. Greene received a nontaxable stock dividend of 50 new common shares in December 1979. On December 15, 1981, Greene sold the 50 new shares of common stock for $5,500. In respect of this sale Greene should report on his 1981 tax return

   a. No gain or loss since the stock dividend was nontaxable.
   b. $500 of long-term capital gain before capital gain deduction.
   c. $1,000 of long-term capital gain before capital gain deduction.
   d. $5,500 of long-term capital gain before capital gain deduction.

43. During 1981 Murray Richman, who is 60 years old and unmarried, was the sole support of his aged mother. His mother was a resident of a home for the aged for the entire year and had no income. What is Richman's filing status for 1981, and how many exemptions should he claim on his tax return?

   a. Head of household and 2 exemptions.
   b. Single and 2 exemptions.
   c. Head of household and 1 exemption.
   d. Single and 1 exemption.

Items 44 through 46 are based on the following information:

Elmer Elmont received Form 1099-DIV from Power Mutual Fund for the calendar year 1981, showing the following information:

Column	*Explanation*	*Amount*
1	Gross dividends	$500
2	Qualifying dividends	$250
3	Nonqualifying dividends	$0
4	Capital gain distributions	$170
5	Nontaxable distributions	$ 80

Elsie Elmont, Elmer's wife, did not own any of the Power Mutual Fund shares, but she did receive $175 in interest on a savings account at the Moss National Bank and $1,475 in interest on U.S. Treasury Certificates. Elmer and Elsie Elmont filed a joint income tax return for 1981.

44. What portion of the dividends is reportable as dividend income (before any exclusion) by the Elmonts?

   a. $0
   b. $250
   c. $420
   d. $500

45. What portion of the interest is reportable as interest income (before any exclusion) by the Elmonts?

   a. $0
   b. $ 175
   c. $1,475
   d. $1,650

46. How should the Elmonts report the capital gain distribution (before any deduction)?

   a. Need **not** be reported.
   b. As ordinary income of $170.
   c. As a short-term capital gain of $170.
   d. As a long-term capital gain of $170.

---

47. Howard O'Brien, an employee of Ogden Corporation, died on June 30, 1981. During July Ogden made employee death payments of $10,000 to his widow, and $10,000 to his 15-year-old son. What amounts should be included in gross income by the widow and son in their respective tax returns for 1981?

	Widow	*Son*
a.	$0	$0
b.	$5,000	$ 5,000
c.	$5,000	$10,000
d.	$7,500	$ 7,500

48. William Linnett, a cash basis sole proprietor, had the following receipts and disbursements for 1981:

Gross receipts	$60,000
Dividend income (on personal investment)	400
Cost of sales	30,000
Other operating expenses	6,000
State business tax	600
Federal self-employment tax	1,600

What amount should Linnett report as net earnings from self-employment for 1981?
a. $24,000
b. $23,800
c. $23,400
d. $21,800

49. Herbert Mann is an engineer employed by a major chemical company. During 1981 he paid the following business related expenses:

Travel expenses incurred while away from home overnight	$2,500
Executive search consultant fees paid in securing a new job in same profession	1,500
Professional society dues	600
Transportation expenses	350

Mann received travel expense reimbursements totaling $2,300 from his employer during 1981. How much should Mann deduct as employee business expenses in arriving at his adjusted gross income for 1981?
a. $ 550
b. $2,050
c. $2,650
d. $2,850

50. Jon Stenger, a cash basis taxpayer, had adjusted gross income of $35,000 in 1981. During the year he incurred and paid the following medical expenses:

Drugs and medicines prescribed by doctors	$ 300
Health insurance premiums	750
Doctors' fees	2,250
Eyeglasses	75
	$3,375

Stenger received $900 in 1981 as reimbursement for a portion of the doctors' fees. If Stenger were to itemize his deductions, what would be his allowable net medical expense deduction?
a. $1,125
b. $1,425
c. $1,650
d. $2,475

51. Charles Wolfe purchased the following long-term investments at par during 1981:

$20,000 general obligation bonds of Burlington County (wholly tax exempt)
$10,000 debentures of Arrow Corporation

Wolfe financed these purchases by obtaining a $30,000 loan from the Union National Bank. For the year 1981, Wolfe made the following interest payments:

Union National Bank	$3,600
Interest on home mortgage	3,000
Interest on credit card charges	500

What amount can Wolfe utilize as interest expense in calculating excess itemized deductions for 1981?
a. $3,500
b. $4,700
c. $5,400
d. $7,100

52. During 1981 Jack and Mary Bronson paid the following taxes:

Taxes on residence (for period January 1 to September 30, 1981)	$2,700
State motor vehicle tax on value of the car	360

The Bronsons sold their house on June 30, 1981, under an agreement in which the real estate taxes were not prorated between the buyer and sellers. What amount should the Bronsons deduct as taxes in calculating excess itemized deductions for 1981?
a. $1,800
b. $2,160
c. $2,700
d. $3,060

53. Judy Bishop had adjusted gross income of $35,000 in 1981 and itemizes her deductions. Additional information is available for 1981 as follows:

Cash contribution to church	$2,500
Purchase of an art object at her church bazaar (with a fair market value of $500 on date of purchase)	800
Donation of used clothes to Goodwill Charities (fair value evidenced by receipt received)	400

What is the maximum amount Bishop can claim as a deduction for charitable contributions in 1981?
a. $2,800
b. $3,200
c. $3,300
d. $3,400

54. The following information is available for Seymour and Ruth Atkinson, who reside in Pennsylvania, for 1981:

Adjusted gross income	$31,500
Tax-exempt interest received	$1,500
Exemptions (including exemption claimed for their son John, a full-time student at State University)	3

An abstract from the Optional Sales Tax Table for Pennsylvania is presented below:

	Sales tax	
	Family size	*Family size*
Income	*1 & 2*	*Over 2*
$30,001-$32,000	$219	$248
$32,001-$34,000	$230	$261

Assuming that the Atkinsons elect to use the Optional Sales Tax Table, what is the maximum amount of general sales taxes that they can utilize in calculating excess itemized deductions for 1981?

a. $219
b. $230
c. $248
d. $261

55. Frank Lanier is a resident of a state that imposes a tax on income. The following information pertaining to Lanier's state income taxes is available:

Taxes withheld in 1981	$3,500
Refund received in 1981 of 1980 tax	400
Deficiency assessed and paid in 1981 for 1979:	
Tax	600
Interest	100

What amount should Lanier utilize as state and local income taxes in calculating excess itemized deductions for his 1981 federal tax return?

a. $3,500
b. $3,700
c. $4,100
d. $4,200

56. On October 1, 1981, Donald Anderson exchanged an apartment building, having an adjusted basis of $375,000 and subject to a mortgage of $100,000, for $25,000 cash and another apartment building with a fair market value of $550,000 and subject to a mortgage of $125,000. The property transfers were made subject to the outstanding mortgages. What amount of gain should Anderson recognize in his tax return for 1981?

a. $0
b. $ 25,000
c. $125,000
d. $175,000

57. During 1981 Mary Culbert paid the following expenses:

Prescription drugs	$470
Aspirin and over-the-counter cold capsules	130
Hospital and doctors (net of insurance reimbursements under plan paid for by her employer)	700
Premiums for a policy to reimburse her for lost income due to illness	350

What is the total amount of medical expenses (before application of any limitation rules) that would enter into the calculation of excess itemized deductions on Culbert's 1981 tax return?

a. $1,170
b. $1,300
c. $1,520
d. $1,650

58. Harold Crowe had the following capital transactions for the year 1981:

$3,000 long-term capital loss
9,000 long-term capital gain
2,000 net short-term capital gain

What is the amount of Crowe's reportable capital gain in the 1981 Schedule D summary?

a. $4,400
b. $5,200
c. $5,600
d. $7,400

59. Philip and Joan Sampson, filing a joint tax return for 1981, had a tax liability of $8,000 computed from the tax table. During 1981 Philip contributed $150 to a candidate for a local elective public office. Assuming that the Sampsons do not claim any other credits against their tax, what is the amount of the political contributions tax credit they should claim on their tax return for 1981?

a. $150
b. $100
c. $ 75
d. $ 50

60. Mark Erickson, age 46, filed a joint return for 1981 with his wife Helen, age 24. Their son John was born on December 16, 1981. Mark provided 60% of the support for his 72-year-old widowed mother until April 10, 1981, when she died. His mother's only income was from social security benefits totaling $1,100 during 1981. How many exemptions should the Ericksons claim on their 1981 tax return?

a. 2
b. 3
c. 4
d. 5

Number 4 (Estimated time —— 45 to 55 minutes)

Number 4 consists of two unrelated parts.

Part a. On January 1, 1982, the partners of Allen, Brown, and Cox, who share profits and losses in the ratio of 5:3:2, respectively, decide to liquidate their partnership. The partnership trial balance at this date is as follows:

	Debit	Credit
Cash	$ 18,000	
Accounts receivable	66,000	
Inventory	52,000	
Machinery and equipment, net	189,000	
Allen, loan	30,000	
Accounts payable		$ 53,000
Brown, loan		20,000
Allen, capital		118,000
Brown, capital		90,000
Cox, capital		74,000
	$355,000	$355,000

The partners plan a program of piecemeal conversion of assets in order to minimize liquidation losses. All available cash, less an amount retained to provide for future expenses, is to be distributed to the partners at the end of each month. A summary of the liquidation transactions is as follows:

January 1982:

a. $51,000 was collected on accounts receivable; the balance is uncollectible.
b. $38,000 was received for the entire inventory.
c. $2,000 liquidation expenses were paid.
d. $50,000 was paid to outside creditors, after offset of a $3,000 credit memorandum received on January 11, 1982.
e. $10,000 cash was retained in the business at the end of the month for potential unrecorded liabilities and anticipated expenses.

February 1982:

f. $4,000 liquidation expenses were paid.
g. $6,000 cash was retained in the business at the end of the month for potential unrecorded liabilities and anticipated expenses.

March 1982:

h. $146,000 was received on sale of all items of machinery and equipment.
i. $5,000 liquidation expenses were paid.
j. No cash was retained in the business.

Required:

Prepare a schedule to compute safe installment payments to the partners as of January 31, 1982. Show supporting computations in good form.

Part b. Greenlaw, Inc., a publishing company, is preparing its December 31, 1981, financial statements and must determine the proper accounting treatment for each of the following situations:

1. Greenlaw sells subscriptions to several magazines for a one-year, two-year, or three-year period. Cash receipts from subscribers are credited to magazine subscriptions collected in advance, and this account had a balance of $2,400,000 at December 31, 1981. Outstanding subscriptions at December 31, 1981, expire as follows:

During 1982	-	$600,000
During 1983	-	900,000
During 1984	-	400,000

2. On January 2, 1981, Greenlaw discontinued collision, fire, and theft coverage on its delivery vehicles and became self-insured for these risks. Actual losses of $45,000 during 1981 were charged to delivery expense. The 1980 premium for the discontinued coverage amounted to $100,000, and the controller wants to set up a reserve for self-insurance by a debit to delivery expense of $55,000 and a credit to the reserve for self-insurance of $55,000.

3. A suit for breach of contract seeking damages of $1,000,000 was filed by an author against Greenlaw on July 1, 1981. The company's legal counsel believes that an unfavorable outcome is probable. A reasonable estimate of the court's award to the plaintiff is in the range between $100,000 and $500,000. No amount within this range is a better estimate of potential damages than any other amount.

4. During December 1981 a competitor company filed suit against Greenlaw for industrial espionage claiming $2,000,000 in damages. In the opinion of management and company counsel, it is reasonably possible that damages will be awarded to the plaintiff. However, the amount of potential damages awarded to the plaintiff cannot be reasonably estimated.

Required:

For each of the situations above, prepare the journal entry that should be recorded as of December 31, 1981, or explain why an entry should not be recorded. Show supporting computations in good form.

Number 5 (Estimated time —— 40 to 50 minutes)

Number 5 consists of two unrelated parts.

Part a. After a two-year search for a buyer, Hobson, Inc., sold its idle plant facility to Jackson Company for $700,000 on January 1, 1977. On this date the plant had a depreciated cost on Hobson's books of $500,000. Under the agreement Jackson paid $100,000 cash on January 1, 1977, and signed a $600,000 note bearing interest at 10%. The note was payable in installments of $100,000, $200,000, and $300,000 on January 1, 1978, 1979 and 1980, respectively. The note was secured by a mortgage on the property sold. Hobson appropriately accounted for the sale under the cost recovery method since there was no reasonable basis for estimating the degree of collectibility of the note receivable. Jackson repaid the note with three late installment payments, which were accepted by Hobson, as follows:

Date of payment	*Principal*	*Interest*
July 1, 1978	$100,000	$90,000
December 31, 1979	200,000	75,000
February 1, 1981	300,000	32,500

On April 1, 1981, Hobson exchanged a tract of land, which it had acquired for $105,000 as a potential future building site, for a used printing press of Tyler Company, and paid a cash difference of $30,000. The fair value of the land was $190,000 on the exchange date based on a recent appraisal. The fair value of the printing press was not reasonably determinable, but it had a depreciated cost of $210,000 on Tyler's books at April 1, 1981.

Required:

1. Prepare a schedule (using the format shown below) to record the initial transaction for the sale of the idle plant facility, the application of subsequent cash collections on the note, and the necessary journal entry on the date the transaction is complete.

Date	*Cash received* *Debit*	*Note receivable* *Dr. (Cr.)*	*Idle plant (net)* *(Credit)*	*Deferred income* *Dr. (Cr.)*	*Income recognized* *(Credit)*
January 1, 1977	$100,000				
July 1, 1978	190,000				
December 31, 1979	275,000				
February 1, 1981	332,500				
February 1, 1981					

2. Prepare the journal entry on Hobson's books to record the exchange transaction with Tyler. Show supporting computations in good form.

Part b. Foster Corporation, a calendar-year company, adopted a noncontributory defined benefit pension plan on January 1, 1980. Foster's actuarial consulting firm recommended a 6% interest rate as appropriate and, applying an acceptable actuarial method, determined that the past service cost at the date of adoption of the plan is $300,000. Management decided to amortize the past service cost over 16 years and to fund the past service cost by making equal payments to the pension fund trustee at the end of each of the first 20 years. As of December 31, 1981, no benefits have vested. The normal (current) pension cost is to be funded fully each year. Information provided by the actuarial consultant relating to the pension plan for the years 1980 and 1981 is as follows:

	1980	*1981*
Amortization of past service cost	$29,685	$29,685
Funding of past service cost	26,155	26,155
Normal pension cost	60,000	65,000

Required:

1. Prepare schedules to compute the amounts relating to the pension plan that Foster should report on its income statement and balance sheet for 1980 and 1981. Show supporting computations in good form.

2. Compute the minimum and maximum pension cost limits allowable under generally accepted accounting principles for 1980. Show supporting computations in good form.

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN ACCOUNTING PRACTICE — PART II

May 6, 1982; 1:30 to 6:00 P.M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	45	55
No. 2	45	55
No. 3	45	55
No. 4	45	55
No. 5	40	50
Total	220	270

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1 . You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2 . Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers. Since objective items are computer-graded, your comments and calculations associated with them are not considered.

3 . For problem-type questions you should enclose all scratch sheets. Failure to enclose scratch sheets may result in loss of grading points. Scratch sheets need not have page numbers, but you should show the question number and place them immediately following the question to which they relate.

4 . Fourteen-column sheets, if any, should not be folded until all sheets, both wide and narrow, are placed in the proper sequence and fastened together at the top left corner. All fourteen-column sheets should then be wrapped around the back of the papers.

5 . A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of financial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on your total correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

97. Gross billings for merchandise sold by Baker Company to its customers last year amounted to $5,260,000; sales returns and allowances reduced the amounts owed by $160,000. How much were net sales last year for Baker Company?
   a. $4,800,000
   b. $5,100,000
   c. $5,200,000
   d. $5,260,000

Answer Sheet

97. (a) ● (c) (d)

Items to be Answered

1. On November 30, 1980, Tyrola Publishing Company, located in Colorado, executed a contract with Ernest Blyton, an author from Canada, providing for payment of 10% royalties on Canadian sales of Blyton's book. Payment is to be made in Canadian dollars each January 10 for the previous year's sales. Canadian sales of the book for the year ended December 31, 1981, totaled $50,000 Canadian. Tyrola paid Blyton his 1981 royalties on January 10, 1982. Tyrola's 1981 financial statements were issued on February 1, 1982. Spot rates for Canadian dollars were as follows:

November 30, 1980	$.87
January 1, 1981	$.88
December 31, 1981	$.89
January 10, 1982	$.90

How much should Tyrola accrue for royalties payable at December 31, 1981?
   a. $4,350
   b. $4,425
   c. $4,450
   d. $4,500

2. On January 2, 1981, Portela, Inc., bought 30% of the outstanding common stock of Bracero Corporation for $258,000 cash. Portela accounts for this investment by the equity method. At the date of acquisition of the stock, Bracero's net assets had a book and fair value of $620,000. The excess of Portela's cost of the investment over its share of Bracero's net assets has an estimated life of 40 years. Bracero's net income for the year ended December 31, 1981, was $180,000. During 1981, Bracero declared and paid cash dividends of $20,000. On December 31, 1981, Portela should have carried its investment in Bracero in the amount of
   a. $234,000
   b. $258,000
   c. $304,200
   d. $306,000

3. The following items were included in Venicio Corporation's inventory account at December 31, 1981:

• Merchandise out on consignment, at sales price, including 40% markup on selling price	$14,000
• Goods purchased, in transit, shipped f.o.b. shipping point	12,000
• Goods held on consignment by Venicio	9,000

Venicio's inventory account at December 31, 1981, should be reduced by
   a. $14,600
   b. $17,400
   c. $23,000
   d. $35,000

4. Warren Construction Company has consistently used the percentage-of-completion method of recognizing income. In 1980, Warren started work on a $6,000,000 construction contract, which was completed in 1981. The accounting records disclosed the following data:

	1981	*1980*
Progress billings	$3,800,000	$2,200,000
Costs incurred	3,600,000	1,800,000
Collections	4,600,000	1,400,000
Estimated cost to complete	—	3,600,000

How much income should Warren have recognized in 1980?
   a. $200,000
   b. $220,000
   c. $300,000
   d. $400,000

5. On January 2, 1979, Tiri Corporation acquired machinery at a cost of $150,000. This machinery was being depreciated by the double declining balance method over an estimated useful life of ten years, with no residual value. At the beginning of 1981, it was decided to change to the straight-line method of depreciation. Ignoring income tax considerations, the cumulative effect of this accounting change is
   a. $0
   b. $24,000
   c. $28,200
   d. $54,000

6. Bicar Corporation owns 10% of the outstanding capital stock of Kopel, Inc. On December 31, 1981, when Kopel's retained earnings was $50,000, Bicar received a plot of land from Kopel in a nonreciprocal transfer. Kopel's cost of the land was $7,000 and its fair market value at December 31, 1981, was $15,000. At what amount should this land be recorded on Bicar's books?
   a. $0
   b. $ 5,000
   c. $ 7,000
   d. $15,000

7. Dale, Inc., a U.S. corporation, bought machine parts from Kluger Company of West Germany on March 1, 1981, for 30,000 marks, when the spot rate for marks was $.4895. Dale's year-end was March 31, 1981, when the spot rate for marks was $.4845. Dale bought 30,000 marks and paid the invoice on April 20, 1981, when the spot rate was $.4945. How much should be shown in Dale's income statements as foreign exchange gain or loss for the years ended March 31, 1981 and 1982?

	1981	*1982*
a.	$0	$0
b.	$0	$150 loss
c.	$150 loss	$0
d.	$150 gain	$300 loss

8. Essex Corporation bought a machine for $105,000 on January 3, 1981. The machine has an estimated useful life of ten years, with no salvage value. The current cost of this machine at December 31, 1981, was $135,000. Using straight-line depreciation on an average current cost basis, how much depreciation should be charged to current cost income from continuing operations for 1981?
   a. $10,500
   b. $12,000
   c. $13,500
   d. $24,000

9. On December 1, 1981, Doram Corporation exchanged 2,000 shares of its $25 par value common stock held in treasury, for a parcel of land to be held for a future plant site. The treasury shares were acquired by Doram at a cost of $40 per share. Doram's common stock had a fair market value of $55 per share on December 1, 1981. Doram received $10,000 for scrap when an existing structure was removed from the site. The land should be capitalized at
   a. $ 70,000
   b. $ 80,000
   c. $100,000
   d. $110,000

10. On January 2, 1980, Troquel Corporation bought 15% of Zafacon Corporation's capital stock for $30,000. Troquel accounts for this investment by the cost method. Zafacon's net income for the years ended December 31, 1980, and December 31, 1981, were $10,000 and $50,000 respectively. During 1981, Zafacon declared a dividend of $70,000. No dividends were declared in 1980. How much should Troquel show on its 1981 income statement as income from this investment?
   a. $ 1,575
   b. $ 7,500
   c. $ 9,000
   d. $10,500

11. On December 31, 1981, Paulison Corporation signed an operating lease for a warehouse with Outwater Company for ten years, at $12,000 per year. Upon execution of the lease, Outwater paid Paulison $24,000, covering rent for the first two years. Paulison closed its books on December 31, and correctly reported $24,000 as gross rental income on its 1981 federal income tax return. How much should be shown in Paulison's 1981 income statement as gross rental income?
   a. $0
   b. $ 1,000
   c. $12,000
   d. $24,000

12. In January 1979, Cameron Corporation established a sinking fund in connection with its issue of bonds due in 1989. A bank was appointed as independent trustee of the fund. At December 31, 1981, the trustee held $364,000 cash in the sinking fund account, representing $300,000 in annual deposits to the fund, and $64,000 of interest earned on those deposits. How should the sinking fund be reported in Cameron's balance sheet at December 31, 1981?
   a. No part of the sinking fund should appear in Cameron's balance sheet.
   b. $64,000 should appear as a current asset.
   c. $364,000 should appear as a current asset.
   d. $364,000 should appear as a noncurrent asset.

13. Howe Corporation bought a cola franchise from Pennington, Inc., on January 2, 1981, for $100,000. A highly regarded independent research company estimated that the remaining useful life of the franchise was 50 years. Its unamortized cost on Pennington's books at January 1, 1981, was $15,000. Howe has decided to write off the franchise over the longest possible period. How much should be amortized for the year ended December 31, 1981?

a. $ 375
b. $ 2,000
c. $ 2,500
d. $15,000

14. The following costs were among those incurred by Woodcroft Corporation during 1981:

Merchandise purchased for resale	$500,000
Salesmen's commissions	40,000
Interest on notes payable to vendors	5,000

How much should be charged to the cost of the merchandise purchases?

a. $500,000
b. $505,000
c. $540,000
d. $545,000

15. On January 1, 1981, when the market rate for bond interest was 14%, Luba Corporation issued bonds in the face amount of $500,000, with interest at 12% payable semiannually. The bonds mature on December 31, 1990, and were issued at a discount of $53,180. How much of the discount should be amortized by the interest method at July 1, 1981?

a. $1,277
b. $2,659
c. $3,191
d. $3,723

16. Kaycee Corporation's revenues for the year ended December 31, 1981, were as follows:

Consolidated revenue per income statement	$1,200,000
Intersegment sales	180,000
Intersegment transfers	60,000
Combined revenues of all industry segments	$1,440,000

Kaycee has a reportable segment if that segment's revenues exceed

a. $ 6,000
b. $ 24,000
c. $120,000
d. $144,000

17. In 1981 Collazo Corporation developed a new product to be marketed in 1982. The following costs were incurred during 1981 in the development of this product:

Research and development departmental costs	$400,000
Materials and supplies consumed	100,000
Compensation paid to research consultants	120,000
Total	$620,000

These costs are expected to be recovered by 1984. How much should be charged to income in 1981 for research and development costs?

a. $0
b. $120,000
c. $500,000
d. $620,000

18. On January 2, 1982, Amadeo Corporation entered into a ten-year noncancelable lease requiring year-end payments of $100,000. Amadeo's incremental borrowing rate is 12%, while the lessor's implicit interest rate, known to Amadeo, is 10%. Present value factors for an ordinary annuity for ten periods are 6.14457 at 10%, and 5.65022 at 12%. Ownership of the property remains with the lessor at expiration of the lease. There is no bargain purchase option. The leased property has an estimated economic life of 12 years. How much should be capitalized by Amadeo for this leased property?

a. $0
b. $ 565,022
c. $ 614,457
d. $1,000,000

19. At December 31, 1981, the following information was available from Crisford Company's books:

	Cost	*Retail*
Inventory, 1/1/81	$14,700	$ 20,300
Purchases	83,300	115,500
Additional markups	—	4,200
Available for sale	$98,000	$140,000

Sales for the year totaled $110,600; markdowns amounted to $1,400. Under the approximate lower of average cost or market retail method, Crisford's inventory at December 31, 1981, was

a. $19,600
b. $21,560
c. $28,000
d. $30,800

20. Reynella Corporation commenced operations on January 1, 1981. For the year ended December 31, 1981, Reynella had pretax income of $1,500,000, after accruing estimated warranty expense of $570,000. Reynella's effective income tax rate was 40%, resulting in income tax payable of $624,000 and deferred income tax of $24,000 at December 31, 1981. What was the amount of actual warranty payments in 1981?

a. $0
b. $510,000
c. $570,000
d. $630,000

Number 2 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of not-for-profit and governmental accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on your total correct answers.

Items to be Answered

21. Glenmore Hospital's property, plant, and equipment (net of depreciation) consists of the following:

Land	$ 500,000
Buildings	10,000,000
Movable equipment	2,000,000

What amount should be included in the restricted fund grouping?

a. $0
b. $ 2,000,000
c. $10,500,000
d. $12,500,000

22. The following assets are among those owned by the City of Foster:

Apartment building (part of the principal of a nonexpendable trust fund)	$ 200,000
City Hall	800,000
Three fire stations	1,000,000
City streets and sidewalks	5,000,000

How much should be included in Foster's general fixed assets account group?

a. $1,800,000 or $6,800,000.
b. $2,000,000 or $7,000,000.
c. $6,800,000, without election of $1,800,000.
d. $7,000,000, without election of $2,000,000.

23. The following items were among Kew Township's expenditures from the general fund during the year ended July 31, 1981:

Minicomputer for tax collector's office	$22,000
Furniture for Township Hall	40,000

How much should be classified as fixed assets in Kew's general fund balance sheet at July 31, 1981?

a. $0
b. $22,000
c. $40,000
d. $62,000

24. During the years ended June 30, 1980 and 1981, Sonata University conducted a cancer research project financed by a $2,000,000 gift from an alumnus. This entire amount was pledged by the donor on July 10, 1979, although he paid only $500,000 at that date. The gift was restricted to the financing of this particular research project. During the two-year research period, Sonata's related gift receipts and research expenditures were as follows:

	Year Ended June 30	
	1980	*1981*
Gift receipts	$1,200,000	$ 800,000
Cancer research expenditures	900,000	1,100,000

How much gift revenue should Sonata report in the restricted column of its statement of current funds revenues, expenditures, and other changes for the year ended June 30, 1981?

a. $0
b. $ 800,000
c. $1,100,000
d. $2,000,000

25. The following balances are included in the subsidiary records of Burwood Village's Parks and Recreation Department at March 31, 1982:

Appropriations - supplies	$7,500
Expenditures - supplies	4,500
Encumbrances - supply orders	750

How much does the Department have available for additional purchases of supplies?

a. $0
b. $2,250
c. $3,000
d. $6,750

Items 26 and 27 are based on the following information:

The following events relating to the City of Albury's debt service funds occurred during the year ended December 31, 1981:

Debt principal matured	$2,000,000
Unmatured (accrued) interest on outstanding debt at Jan. 1, 1981	50,000
Interest on matured debt	900,000
Unmatured (accrued) interest on outstanding debt at Dec. 31, 1981	100,000
Interest revenue from investments	600,000
Cash transferred from general fund for retirement of debt principal	1,000,000
Cash transferred from general fund for payment of matured interest	900,000

All principal and interest due in 1981 were paid on time.

26. What is the total amount of expenditures that Albury's debt service funds should record for the year ended December 31, 1981?
   a. $ 900,000
   b. $ 950,000
   c. $2,900,000
   d. $2,950,000

27. How much revenue should Albury's debt service funds record for the year ended December 31, 1981?
   a. $ 600,000
   b. $1,600,000
   c. $1,900,000
   d. $2,500,000

28. The Board of Commissioners of the City of Rockton adopted its budget for the year ending July 31, 1982, which indicated revenues of $1,000,000 and appropriations of $900,000. If the budget is formally integrated into the accounting records, what is the required journal entry?

		Dr.	Cr.
a.	Memorandum entry only		
b.	Appropriations	$ 900,000	
	General fund	100,000	
	Estimated revenues		$1,000,000
c.	Estimated revenues	$1,000,000	
	Appropriations		$ 900,000
	Fund balance		100,000
d.	Revenues receivable	$1,000,000	
	Expenditures payable		$ 900,000
	General fund balance		100,000

29. Kingsford City incurred $100,000 of salaries and wages for the month ended March 31, 1982. How should this be recorded at that date?

		Dr.	Cr.
a.	Expenditures - salaries and wages	$100,000	
	Vouchers payable		$100,000
b.	Salaries and wages expense	$100,000	
	Vouchers payable		$100,000
c.	Encumbrances - salaries and wages	$100,000	
	Vouchers payable		$100,000
d.	Fund balance	$100,000	
	Vouchers payable		$100,000

30. During the year ended December 31, 1981, Melford Hospital received the following donations stated at their respective fair values:

Employee services from members of a religious group	$100,000
Medical supplies from an association of physicians. These supplies were restricted for indigent care, and were used for such purpose in 1981	30,000

How much revenue (both operating and nonoperating) from donations should Melford report in its 1981 statement of revenues and expenses?
   a. $0
   b. $ 30,000
   c. $100,000
   d. $130,000

31. On January 2, 1982, John Reynolds established a $500,000 trust, the income from which is to be paid to Mansfield University for general operating purposes. The Wyndham National Bank was appointed by Reynolds as trustee of the fund. What journal entry is required on Mansfield's books?

		Dr.	Cr.
a.	Memorandum entry only		
b.	Cash	$500,000	
	Endowment fund balance		$500,000
c.	Nonexpendable endowment fund	$500,000	
	Endowment fund balance		$500,000
d.	Expendable funds	$500,000	
	Endowment fund balance		$500,000

Items 32 and 33 are based on the following information:

During the year ended December 31, 1981, Leyland City received a state grant of $500,000 to finance the purchase of buses, and an additional grant of $100,000 to aid in the financing of bus operations in 1981. Only $300,000 of the capital grant was used in 1981 for the purchase of buses, but the entire operating grant of $100,000 was spent in 1981.

32. If Leyland's bus transportation system is accounted for as part of the city's general fund, how much should Leyland report as grant revenues for the year ended December 31, 1981?
    a. $100,000
    b. $300,000
    c. $400,000
    d. $500,000

33. If Leyland's bus transportation system is accounted for as an enterprise fund, how much should Leyland report as grant revenues for the year ended December 31, 1981?
    a. $100,000
    b. $300,000
    c. $400,000
    d. $500,000

34. For the fall semester of 1981, Cranbrook College assessed its students $2,300,000 for tuition and fees. The net amount realized was only $2,100,000 because of the following revenue reductions:

Refunds occasioned by class cancellations and student withdrawals	$ 50,000
Tuition remissions granted to faculty members' families	10,000
Scholarships and fellowships	140,000

How much should Cranbrook report for the period for unrestricted current funds revenues from tuition and fees?
    a. $2,100,000
    b. $2,150,000
    c. $2,250,000
    d. $2,300,000

35. Ariel Village issued the following bonds during the year ended June 30, 1981:

Revenue bonds to be repaid from admission fees collected by the Ariel Zoo enterprise fund	$200,000
General obligation bonds issued for the Ariel water and sewer enterprise fund which will service the debt	300,000

How much of these bonds should be accounted for in Ariel's general long-term debt account group?
    a. $0
    b. $200,000
    c. $300,000
    d. $500,000

Items 36 and 37 are based on the following information:

On December 31, 1981, Madrid Township paid a contractor $2,000,000 for the total cost of a new firehouse built in 1981 on Township-owned land. Financing was by means of a $1,500,000 general obligation bond issue sold at face amount on December 31, 1981, with the remaining $500,000 transferred from the general fund.

36. What should be reported on Madrid's 1981 financial statements for the capital project fund?
    a. Revenues, $1,500,000; Expenditures, $1,500,000.
    b. Revenues, $1,500,000; Other financing sources, $500,000; Expenditures, $2,000,000.
    c. Revenues, $2,000,000; Expenditures, $2,000,000.
    d. Other financing sources, $2,000,000; Expenditures, $2,000,000.

37. What should be reported on Madrid's 1981 financial statements for the general fund?
    a. Expenditures, $500,000.
    b. Other financing uses, $500,000.
    c. Revenues, $1,500,000; Expenditures, $2,000,000.
    d. Revenues, $1,500,000; Other financing uses, $2,000,000.

Items 38 and 39 are based on the following information:

The following balances appeared in the City of Reedsbury's general fund at June 30, 1981:

Account	*Balance* *Dr. (Cr.)*
Encumbrances - current year	$ 200,000
Expenditures:	
Current year	3,000,000
Prior year	100,000
Fund balance reserved for encumbrances:	
Current year	(200,000)
Prior year	None

Reedsbury maintains its general fund books on a legal budgetary basis, requiring revenues and expenditures to be accounted for on a modified accrual basis. In addition, the sum of current year expenditures and encumbrances cannot exceed current year appropriations.

38. What total amount of expenditures (and encumbrances, if appropriate) should Reedsbury report in the general fund column of its combined statement of revenues, expenditures, and changes in fund balance for the year ended June 30, 1981?
   a. $3,000,000
   b. $3,100,000
   c. $3,200,000
   d. $3,300,000

39. What total amount of expenditures (and encumbrances, if appropriate) should Reedsbury report in the general fund "actual" column of its combined statement of revenues, expenditures, and changes in fund balance - budget and actual - for the year ended June 30, 1981?
   a. $3,000,000
   b. $3,100,000
   c. $3,200,000
   d. $3,300,000

40. On July 1, 1981, Lilydale Hospital's Board of Trustees designated $200,000 for expansion of outpatient facilities. The $200,000 is expected to be expended in the fiscal year ending June 30, 1984. In Lilydale's balance sheet at June 30, 1982, this cash should be classified as a $200,000
   a. Restricted current asset.
   b. Restricted noncurrent asset.
   c. Unrestricted current asset.
   d. Unrestricted noncurrent asset.

Number 3 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **the federal income taxation of corporations and partnerships.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. The answers should be based upon 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. Mark only one answer for each item. Answer all items.** Your grade will be based on your total correct answers.

Items to be Answered

41. Cooma Corporation's book income before income taxes for the year ended December 31, 1981, was $260,000. The company was organized three years earlier. Organization costs of $130,000 are being written off over a ten-year period for financial statement purposes. For tax purposes these costs are being written off over the minimum allowable period. For the year ended December 31, 1981, Cooma's taxable income was
   a. $234,000
   b. $247,000
   c. $260,000
   d. $273,000

42. Sportsworld, Inc., issued $500,000 face amount of bonds in 1976, and established a sinking fund to pay the debt. An independent trustee was appointed by the bondholders to administer the sinking fund. In 1981, the sinking fund earned $30,000 in interest on bank deposits, and $2,000 in net short-term capital gains. How much of this income is taxable to Sportsworld?
   a. $0
   b. $ 2,000
   c. $30,000
   d. $32,000

43. Bruce Williams owns 55% of the outstanding stock of Flextool Corporation. During 1981, Flextool sold a machine to Williams for $40,000. The machine had an adjusted tax basis of $46,000, and had been owned by Flextool for three years. What is the allowable loss that Flextool can claim in its 1981 income tax return?
   a. $0.
   b. $6,000 ordinary loss.
   c. $6,000 Section 1231 loss.
   d. $6,000 Section 1245 loss.

44. Daystar Corp., which is not a mere holding or investment company, derives its income from consulting services. Daystar had accumulated earnings and profits of $45,000 at December 31, 1980. For the year ended December 31, 1981, it had earnings and profits of $115,000 and a dividends-paid deduction of $15,000. It has been determined that $20,000 of the accumulated earnings and profits for 1981 is required for the reasonable needs of the business. How much is the allowable accumulated earnings credit at December 31, 1981?

a. $105,000
b. $125,000
c. $150,000
d. $250,000

45. On July 1, 1981, Alan Rees, sole proprietor of Kee Nail, transferred all of Kee's assets to Merit, Inc., a new corporation, solely in exchange for a certain percentage of Merit's stock. Al Clyde, who is not related to Rees, bought the rest of Merit's stock on July 1. Merit's outstanding capital stock consisted of 1,000 shares of common stock with a par value of $100 per share. For the transfer of Kee's assets to be tax-free, what is the minimum number of shares of Merit's stock that must be owned by Rees immediately after the exchange?

a. 500
b. 501
c. 800
d. 801

46. Pursuant to a tax-free reorganization in 1981, Sandra Peel exchanged 100 shares of Lorna Corporation for 100 shares of Wood Corp., and in addition received $1,000 cash, which was not in excess of Peel's ratable share of Lorna's undistributed earnings and profits. Peel paid $20,000 in 1975 for the Lorna stock. The Wood stock had a fair market value of $24,000 on the date of the exchange. What is the recognized gain to be reported by Peel in 1981?

a. $0.
b. $1,000 dividend.
c. $1,000 long-term capital gain.
d. $5,000 long-term capital gain.

47. On October 1, 1980, Arosa Corporation adopted a plan for a 12-month, complete liquidation. Land, with an adjusted basis of $30,000 bought in 1975 for investment, was sold for $90,000 on December 10, 1980. Negotiations for the sale of this land commenced in September 1980. On November 1, 1981, Arosa distributed all of its assets to the stockholders. What is Arosa's recognized gain in 1980 on the sale of the land?

a. $0.
b. $60,000 ordinary income.
c. $60,000 long-term capital gain.
d. $60,000 Section 1245 gain.

48. Dowell Corporation had operating income of $100,000, after deducting $6,000 for contributions, but not including dividends of $10,000 received from non-affiliated domestic taxable corporations. How much is the base amount to which the percentage limitation should be applied in computing the maximum allowable deduction for contributions?

a. $106,000
b. $107,500
c. $110,000
d. $116,000

49. Monaro Corporation had the following income and expenses for the year ended December 31, 1981:

Gross profit on sales	$300,000
Administrative expenses	700,000
Dividends from nonaffiliated domestic taxable corporations	20,000

How much is Monaro's net operating loss for 1981?

a. $380,000
b. $383,000
c. $397,000
d. $400,000

50. Olex Corporation's books disclosed the following data for the calendar year 1981:

Retained earnings at beginning of year	$50,000
Net income for year	70,000
Contingency reserve established at end of year	10,000
Cash dividends paid during year	8,000

What amount should appear on the last line of reconciliation Schedule M-2 of Form 1120?

a. $102,000
b. $120,000
c. $128,000
d. $138,000

51. Hazelwood Corporation (a calendar-year taxpayer) was organized on July 1, 1981, with paid-in capital of $300,000. A valid election was filed for Subchapter S status. Prior to commencement of operations, the funds were deposited in savings certificates. Sales and interest income for the short taxable year ended December 31, 1981, aggregated $250,000. Of that total, what is the maximum amount that can constitute interest, in order for Hazelwood to avoid loss of its Subchapter S status?

a. $ 2,999
b. $ 3,000
c. $49,999
d. $50,000

52. Brooke, Inc., a Subchapter S corporation, was organized on January 2, 1981, with two equal stockholders. Each stockholder invested $5,000 in Brooke's capital stock, and each loaned $15,000 to the corporation. Brooke then borrowed $60,000 from a bank for working capital. Brooke sustained an operating loss of $90,000 for the year ended December 31, 1981. How much of this loss can each stockholder claim on his 1981 income tax return?
   a. $ 5,000
   b. $20,000
   c. $45,000
   d. $50,000

53. In 1976, Celia Mueller bought a $1,000 bond issued by Disco Corporation, for $1,100. Instead of paying off the bondholders in cash, Disco issued 100 shares of preferred stock in 1981 for each bond outstanding. The preferred stock had a fair market value of $15 per share. What is the recognized gain to be reported by Mueller in 1981?
   a. $0.
   b. $400 dividend.
   c. $400 long-term capital gain.
   d. $500 long-term capital gain.

54. In 1981, Pianca Corporation bought the following new assets, both of which are in the five-year class under the accelerated cost recovery system:

Asset	*Cost*
Solar panels	$ 8,000
Shredder for recycling of aluminum cans	12,000

Pianca claimed the regular investment credit in 1981 for the qualifying property. What is the total amount of the above-mentioned assets eligible in 1981 for the business energy investment credit?
   a. $0
   b. $ 8,000
   c. $12,000
   d. $20,000

55. Debra Wallace and Joan Pedersen are equal partners in the capital and profits of Wallace & Pedersen, but are otherwise unrelated. On August 1, 1981, Wallace sold 100 shares of Kiandra Mining Corporation stock to the partnership for its fair market value of $7,000. Wallace had bought the stock in 1975 at a cost of $10,000. What is Wallace's recognized loss in 1981 on the sale of this stock?
   a. $0.
   b. $1,500 long-term capital loss.
   c. $3,000 long-term capital loss.
   d. $3,000 ordinary loss.

56. On July 1, 1981, Lydia Amador received a 10% interest in the capital of Nido Associates, a partnership, for services rendered. Nido's net assets at July 1 had a basis of $70,000 and a fair market value of $100,000. What income must Lydia include in her 1981 tax return for the partnership interest transferred to her by the other partners?
   a. $0.
   b. $ 7,000 ordinary income.
   c. $10,000 ordinary income.
   d. $10,000 long-term capital gain.

57. On July 1, 1981, Bertram Bryant acquired a 30% interest in Windward Company, a partnership, by contributing property with an adjusted basis of $5,000 and a fair market value of $12,000. The property was subject to a mortgage of $8,000, which was assumed by Windward. What is Bryant's basis of his interest in Windward?
   a. $0
   b. $4,000
   c. $5,000
   d. $6,400

58. On September 1, 1981, James Elton received a 25% capital interest in Bredbo Associates, a partnership, in return for services rendered plus a contribution of assets with a basis to Elton of $25,000 and a fair market value of $40,000. The fair market value of Elton's 25% interest was $50,000. How much is Elton's basis for his interest in Bredbo?
   a. $25,000
   b. $35,000
   c. $40,000
   d. $50,000

59. On July 1, 1981, Donald Ambrose was admitted to partnership in the firm of Martin & Matthews. His contribution to capital consisted of 500 shares of stock in Cathcart Corporation, which he bought in 1970 for $10,000 and which had a fair market value of $50,000 on July 1, 1981. Ambrose's interest in the partnership's capital and profits is 25%. On July 1, 1981, the fair market value of the partnership's net assets (after Ambrose was admitted) was $200,000. What was Ambrose's gain in 1981 on the exchange of stock for his partnership interest?
   a. $0.
   b. $40,000 ordinary income.
   c. $40,000 long-term capital gain.
   d. $40,000 Section 1231 gain.

60. On July 1, 1981, Pemberton Corporation bought a new drill press for $20,000, which was placed in service the same day. The drill press qualifies as five-year accelerated cost recovery system property, for which an investment credit of $2,000 was claimed. If Pemberton disposes of this drill press on May 31, 1983, how much of the investment credit must be recaptured in 1983?

a. $0
b. $1,200
c. $1,600
d. $2,000

Number 4 (Estimated time —— 45 to 55 minutes)

The following information pertains to Woodbine Circle Corporation:

Adjusted Trial Balance
December 31, 1981

	Dr.	Cr.
Cash	$ 500,000	
Accounts receivable, net	1,500,000	
Inventory	2,500,000	
Property, plant, and equipment	15,100,000	
Accumulated depreciation		$ 4,900,000
Accounts payable		1,400,000
Income taxes payable		100,000
Notes payable		1,000,000
Common stock ($1 par value)		1,100,000
Additional paid-in capital		6,100,000
Retained earnings, 1/1/81		3,000,000
Sales — regular		10,000,000
Sales — AL Division		2,000,000
Interest on municipal bonds		100,000
Cost of sales — regular	6,200,000	
Cost of sales — AL Division	900,000	
Administrative expenses — regular	2,000,000	
Administrative expenses — AL Division	300,000	
Interest expense — regular	210,000	
Interest expense — AL Division	140,000	
Loss on disposal of AL Division	250,000	
Gain on repurchase of bonds payable		300,000
Income tax expense	400,000	
	$30,000,000	$30,000,000

Other financial data for the year ended December 31, 1981:

Federal income taxes

Paid on Federal Tax Deposit Forms 503	$ 300,000
Accrued	100,000
Total charged to income tax expense (estimated)	$ 400,000*
*Does not properly reflect current or deferred income tax expense or intraperiod income tax allocation for income statement purposes	
Income per tax return	$2,150,000
Tax rate on all types of taxable income	40%

Timing difference

Depreciation, per financial statements	$ 600,000
Depreciation, per tax return	750,000

Permanent difference

Interest on municipal bonds	100,000

Discontinued operations

On September 30, 1981, Woodbine sold its Auto Leasing (AL) Division for $4,000,000. Book value of this business segment was $4,250,000 at that date. For financial statement purposes, this sale was considered as discontinued operations of a segment of a business. Since there was no phase-out period, the measurement date was September 30, 1981.

Liabilities

On June 30, 1981, Woodbine repurchased $1,000,000 carrying value of its long-term bonds for $700,000. All other liabilities mature in 1982.

Capital structure

Common stock, par value $1 per share, traded on the New York Stock Exchange:

Number of shares outstanding at 1/1/81	900,000
Number of shares sold for $8 per share on 6/30/81	200,000
Number of shares outstanding at 12/31/81	1,100,000

Required:

Using the multiple-step format, prepare a formal income statement for Woodbine for the year ended December 31, 1981, together with the appropriate supporting schedules. Recurring and nonrecurring items in the income statement should be properly separated. All income taxes should be appropriately shown.

Number 5 (Estimated time —— 40 to 50 minutes)

Number 5 consists of two unrelated parts.

Part a. Lares Confectioners, Inc., makes a candy bar called Rey, which sells for $.50 per pound. The manufacturing process also yields a product known as Nagu. Without further processing, Nagu sells for $.10 per pound. With further processing, Nagu sells for $.30 per pound. During the month of April, total joint manufacturing costs up to the point of separation consisted of the following charges to work in process:

Raw materials	$150,000
Direct labor	120,000
Factory overhead	30,000

Production for the month aggregated 394,000 pounds of Rey and 30,000 pounds of Nagu. To complete Nagu during the month of April and obtain a selling price of $.30 per pound, further processing of Nagu during April would entail the following additional costs:

Raw materials	$2,000
Direct labor	1,500
Factory overhead	500

Required:

Prepare the April journal entries for Nagu, if Nagu is:

1. Transferred as a by-product at sales value to the warehouse without further processing, with a corresponding reduction of Rey's manufacturing costs.
2. Further processed as a by-product and transferred to the warehouse at net realizable value, with a corresponding reduction of Rey's manufacturing costs.
3. Further processed and transferred to finished goods, with joint costs being allocated between Rey and Nagu based on relative sales value at the split-off point.

Part b. The following information was available from Montero Corporation's books:

1982	*Purchases*	*Sales*
Jan.	$42,000	$72,000
Feb.	48,000	66,000
Mar.	36,000	60,000
Apr.	54,000	78,000

Collections from customers are normally 70% in the month of sale, 20% in the month following the sale, and 9% in the second month following the sale. The balance is expected to be uncollectible. Montero takes full advantage of the 2% discount allowed on purchases paid for by the tenth of the following month. Purchases for May are budgeted at $60,000, while sales for May are forecasted at $66,000. Cash disbursements for expenses are expected to be $14,400 for the month of May. Montero's cash balance at May 1 was $22,000.

Required:

Prepare the following schedules:

1. Expected cash collections during May.
2. Expected cash disbursements during May.
3. Expected cash balance at May 31.

Uniform Certified Public Accountant Examination

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN AUDITING

May 6, 1982; 8:30 A.M. to 12:00 M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	90	110
No. 2	15	25
No. 3	15	25
No. 4	15	25
No. 5	15	25
Total	150	210

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers.

3. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 90 to 110 minutes)

Instructions

Select the **best** answer for each of the following items. Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on your total correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

96. One of the generally accepted auditing standards specifies that the auditor should
   a. Inspect all fixed assets acquired during the year.
   b. Charge fair fees based on cost.
   c. Make a proper study and evaluation of the existing internal control.
   d. Count client petty cash funds.

Answer Sheet

96. ⓐ ⓑ ● ⓓ

Items to be Answered

1. If all other factors specified in an attribute sampling plan remain constant, changing the specified precision from 6% to 10%, and changing the specified reliability from 97% to 93%, would cause the required sample size to
   a. Increase.
   b. Remain the same.
   c. Decrease.
   d. Change by 4%.

2. An auditor initially planned to use unrestricted random sampling with replacement in the examination of accounts receivable. Later, the auditor decided to use unrestricted random sampling without replacement. As a result only of this decision, the sample size should
   a. Increase.
   b. Remain the same.
   c. Decrease.
   d. Be recalculated using a binomial distribution.

3. To test for unsupported entries in the ledger, the direction of audit testing should be from the
   a. Ledger entries.
   b. Journal entries.
   c. Externally generated documents.
   d. Original source documents.

4. In an audit situation, communication between successor and predecessor auditors should be
   a. Authorized in an engagement letter.
   b. Acknowledged in a representation letter.
   c. Either written or oral.
   d. Written and included in the working papers.

5. The precision limit for compliance tests necessary to justify reliance on internal accounting control depends primarily on which of the following?
   a. The cause of errors.
   b. The extent of reliance to be placed on the procedures.
   c. The amount of any substantive errors.
   d. The limit used in audits of similar clients.

6. Which of the following statements relating to the competence of evidential matter is always true?
   a. Evidential matter gathered by an auditor from outside an enterprise is reliable.
   b. Accounting data developed under satisfactory conditions of internal control are more relevant than data developed under unsatisfactory internal control conditions.
   c. Oral representations made by management are **not** valid evidence.
   d. Evidence gathered by auditors must be both valid and relevant to be considered competent.

7. The auditor will **not** ordinarily initiate discussion with the audit committee concerning the
   a. Extent to which the work of internal auditors will influence the scope of the examination.
   b. Extent to which change in the company's organization will influence the scope of the examination.
   c. Details of potential problems which the auditor believes might cause a qualified opinion.
   d. Details of the procedures which the auditor intends to apply.

8. The auditor observes client employees during the review of the system of internal control in order to
   a. Prepare a flowchart.
   b. Update information contained in the organization and procedure manuals.
   c. Corroborate the information obtained during the initial review of the system.
   d. Determine the extent of compliance with quality control standards.

9. A CPA who is associated with the financial statements of a public entity, but has **not** audited or reviewed such statements, should
   a. Insist that they be audited or reviewed before publication.
   b. Read them to determine whether there are obvious material errors.
   c. State these facts in the accompanying notes to the financial statements.
   d. Issue a compilation report.

10. Which of the following is the best argument against the use of negative accounts receivable confirmations?
   a. The cost-per-response is excessively high.
   b. There is **no** way of knowing if the intended recipients received them.
   c. Recipients are likely to feel that in reality the confirmation is a subtle request for payment.
   d. The inference drawn from receiving no reply may **not** be correct.

11. The Foreign Corrupt Practices Act requires that
   a. Auditors engaged to examine the financial statements of publicly-held companies report all illegal payments to the SEC.
   b. Publicly-held companies establish independent audit committees to monitor the effectiveness of their system of internal control.
   c. U.S. firms doing business abroad report sizable payments to non U.S. citizens to the Justice Department.
   d. Publicly-held companies devise and maintain an adequate system of internal accounting control.

12. An auditor compares 1981 revenues and expenses with those of the prior year and investigates all changes exceeding 10%. By this procedure the auditor would be most likely to learn that
   a. An increase in property tax rates has **not** been recognized in the client's accrual.
   b. The 1981 provision for uncollectible accounts is inadequate, because of worsening economic conditions.
   c. Fourth quarter payroll taxes were **not** paid.
   d. The client changed its capitalization policy for small tools in 1981.

13. Which of the following is ordinarily considered a compliance audit procedure?
   a. Send confirmation letters to banks.
   b. Count and list cash on hand.
   c. Examine signatures on checks.
   d. Obtain or prepare reconciliations of bank counts as of the balance sheet date.

14. Customers having substantial year-end past due balances fail to reply after second request forms have been mailed directly to them. Which of the following is the most appropriate audit procedure?
   a. Examine shipping documents.
   b. Review collections during the year being examined.
   c. Intensify the study of the client's system of internal control with respect to receivables.
   d. Increase the balance in the accounts receivable allowance (contra) account.

15. Which of the following is the most reliable analytical review approach to verification of the year-end financial statement balances of a wholesale business?
   a. Verify depreciation expense by multiplying the depreciable asset balances by one divided by the depreciation rate.
   b. Verify commission expense by multiplying sales revenue by the company's standard commission rate.
   c. Verify interest expense, which includes imputed interest, by multiplying long term debt balances by the year-end prevailing interest rate.
   d. Verify FICA tax liability by multiplying total payroll costs by the FICA contribution rate in effect during the year.

16. An auditor who was engaged to perform an examination of the financial statements of a nonpublic entity has been asked by the client to refrain from performing various audit procedures and change the nature of the engagement to a review of the financial statements in accordance with standards established by the AICPA. The client's request was made because the cost to complete the examination was significant. Under the circumstances the auditor would most likely
   a. Qualify the auditor's report and refer to the scope limitation.
   b. View the request as an indication of a possible irregularity.
   c. Complete the examination which was in progress.
   d. Honor the client's request.

17. A major customer of an audit client suffers a fire just prior to completion of year-end field work. The audit client believes that this event could have a significant direct effect on the financial statements. The auditor should
   a. Advise management to disclose the event in notes to the financial statements.
   b. Disclose the event in the auditor's report.
   c. Withhold submission of the auditor's report until the extent of the direct effect on the financial statements is known.
   d. Advise management to adjust the financial statements.

18. Budd, the purchasing agent of Lake Hardware Wholesalers, has a relative who owns a retail hardware store. Budd arranged for hardware to be delivered by manufacturers to the retail store on a C.O.D. basis, thereby enabling his relative to buy at Lake's wholesale prices. Budd was probably able to accomplish this because of Lake's poor internal control over
    a. Purchase requisitions.
    b. Cash receipts.
    c. Perpetual inventory records.
    d. Purchase orders.

19. The third standard of field work states that sufficient competent evidential matter may, in part, be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination. The evidential matter required by this standard may, in part, be obtained through
    a. Auditor working papers.
    b. Proper planning of the audit engagement.
    c. Analytical review procedures.
    d. Review of the system of internal control.

20. In which of the following instances would the independence of the CPA **not** be considered to be impaired? The CPA has been retained as the auditor of a brokerage firm
    a. Which owes the CPA audit fees for more than one year.
    b. In which the CPA has a large active margin account.
    c. In which the CPA's brother is the controller.
    d. Which owes the CPA audit fees for current-year services and has just filed a petition for bankruptcy.

21. When a client declines to include a statement of changes in financial position in its financial report, the auditor's report will usually
    a. Contain a qualified opinion because of inadequate disclosure.
    b. Include a separate paragraph which summarizes the company's financing and investing activities.
    c. Refer to a footnote which contains an auditor prepared statement of changes in financial position.
    d. Refer to the scope limitation.

22. When auditing contingent liabilities, which of the following procedures would be **least** effective?
    a. Reading the minutes of the board of directors.
    b. Reviewing the bank confirmation letter.
    c. Examining customer confirmation replies.
    d. Examining invoices for professional services.

23. Pursuant to the AICPA rules of conduct, the auditor's responsibility to the profession is defined by
    a. The AICPA Code of Professional Ethics.
    b. Federal laws governing licensed professionals who are involved in interstate commerce.
    c. Statements on Auditing Standards.
    d. The Bylaws of the AICPA.

24. The use of fidelity bonds protects a company from embezzlement losses and also
    a. Minimizes the possibility of employing persons with dubious records in positions of trust.
    b. Reduces the company's need to obtain expensive business interruption insurance.
    c. Allows the company to substitute the fidelity bonds for various parts of internal accounting control.
    d. Protects employees who made unintentional errors from possible monetary damages resulting from such errors.

25. A CPA who is seeking to sell an accounting practice must
    a. Not allow a peer review team to look at working papers and tax returns without permission from the client prior to consummation of the sale.
    b. Not allow a prospective purchaser to look at working papers and tax returns without permission from the client.
    c. Give all working papers and tax returns to the client.
    d. Retain all working papers and tax returns for a period of time sufficient to satisfy the statute of limitations.

26. Whenever special reports, filed on a printed form designed by authorities, call upon the independent auditor to make an assertion that the auditor believes is **not** justified, the auditor should
    a. Submit a short-form report with explanations.
    b. Reword the form or attach a separate report.
    c. Submit the form with questionable items clearly omitted.
    d. Withdraw from the engagement.

27. More than one file may be stored on a single magnetic memory disc. Several programs may be in the core storage unit simultaneously. In both cases it is important to prevent the mixing of data. One way to do this is to use
    a. File integrity control.
    b. Boundary protection.
    c. Interleaving.
    d. Paging.

28. The predecessor auditor, after properly communicating with the successor auditor, has reissued a report because the audit client desires comparative financial statements. The predecessor auditor's report should make
   a. No reference to the report or the work of the successor auditor.
   b. Reference to the work of the successor auditor in the scope paragraph.
   c. Reference to both the work and the report of the successor auditor in the opinion paragraph.
   d. Reference to the report of the successor auditor in the scope paragraph.

29. A change from a cash to working capital presentation in the statement of changes in financial position constitutes a change which requires
   a. Only a disclosure in the auditor's report.
   b. That the auditor's opinion contain a "subject to" qualification as to consistency.
   c. That the auditor's opinion contain an exception as to conformity with generally accepted accounting principles.
   d. That the auditor's report contain an exception as to consistency in the opinion paragraph.

30. Which of the following, if material, would be an irregularity as defined in Statements on Auditing Standards?
   a. Errors in the application of accounting principles.
   b. Errors in the accounting data underlying the financial statements.
   c. Misinterpretation of facts that existed when the financial statements were prepared.
   d. Misappropriation of assets.

31. Basic financial statements which would otherwise receive an unqualified opinion do not contain certain supplementary information that is required to be presented pursuant to an FASB pronouncement. The auditor must identify, in an additional paragraph, the supplementary information that is omitted and express a (an)
   a. "Except for" opinion.
   b. Disclaimer of opinion.
   c. Adverse opinion.
   d. Unqualified opinion.

32. To minimize the opportunities for fraud, unclaimed cash payroll should be
   a. Deposited in a safe deposit box.
   b. Held by the payroll custodian.
   c. Deposited in a special bank account.
   d. Held by the controller.

33. Mavis, CPA, has audited the financial statements of South Bay Sales Incorporated for several years and had always been paid promptly for services rendered. Last year's audit invoices have not been paid because South Bay is experiencing cash flow difficulties, and the current year's audit is scheduled to commence in one week. With respect to the past due audit fees Mavis should
   a. Perform the scheduled audit and allow South Bay to pay when the cash flow difficulties are alleviated.
   b. Perform the scheduled audit only after arranging a definite payment schedule and securing notes signed by South Bay.
   c. Inform South Bay's management that the past due audit fees are considered an impairment of auditor independence.
   d. Inform South Bay's management that the past due audit fees may be considered a loan on which interest must be imputed for financial statement purposes.

34. Within the context of quality control, the primary purpose of continuing professional education and training activities, is to enable a CPA firm to provide personnel within the firm with
   a. Technical training that assures proficiency as an auditor.
   b. Professional education that is required in order to perform with due professional care.
   c. Knowledge required to fulfill assigned responsibilities and to progress within the firm.
   d. Knowledge required in order to perform a peer review.

35. With respect to the auditor's planning of a year-end examination, which of the following statements is always true?
   a. An engagement should **not** be accepted after the fiscal year end.
   b. An inventory count must be observed at the balance sheet date.
   c. The client's audit committee should **not** be told of the specific audit procedures which will be performed.
   d. It is an acceptable practice to carry out substantial parts of the examination at interim dates.

36. An independent auditor finds that Simner Corporation occupies office space, at no charge, in an office building owned by a shareholder. This finding indicates the existence of
   a. Management fraud.
   b. Related party transactions.
   c. Window dressing.
   d. Weak internal control.

47. When negotiable securities are of considerable volume, planning by the auditor is necessary to guard against
   a. Unauthorized negotiation of the securities before they are counted.
   b. Unrecorded sales of securities after they are counted.
   c. Substitution of securities already counted for other securities which should be on hand but are **not**.
   d. Substitution of authentic securities with counterfeit securities.

48. In which of the following instances would the independence of the CPA **not** be considered to be impaired? The CPA has been retained as the auditor of a
   a. Charitable organization in which an employee of the CPA serves as treasurer.
   b. Municipality in which the CPA owns $25,000 of the $2,500,000 indebtedness of the municipality.
   c. Cooperative apartment house in which the CPA owns an apartment and is **not** part of the management.
   d. Company in which the CPA's investment club owns a one-tenth interest.

49. Management's refusal to furnish a written representation on a matter which the auditor considers essential constitutes
   a. Prima facie evidence that the financial statements are **not** presented fairly.
   b. A violation of the Foreign Corrupt Practices Act.
   c. An uncertainty sufficient to preclude an unqualified opinion.
   d. A scope limitation sufficient to preclude an unqualified opinion.

50. For financial reporting purposes, a change from straight-line to an accelerated depreciation method was disclosed in a note to the financial statements and has an **immaterial** effect on the current financial statements. It is expected, however, that the change will have a significant effect on future periods. The auditor should express a (an)
   a. Consistency exception.
   b. Adverse opinion.
   c. Unqualified opinion.
   d. "Subject to" opinion.

51. For effective internal control, the billing function should be performed by the
   a. Accounting department.
   b. Sales department.
   c. Shipping department.
   d. Credit and collection department.

52. The preparer of a federal income tax return signs a preparer's declaration which states:

> Under penalties of perjury, I declare that I have examined this return ... and to the best of my knowledge and belief it is true, correct, and complete.

A CPA who signs this declaration as preparer of a client's tax return warrants that
   a. Information furnished by the client was relied upon in preparing the tax return unless it appeared incorrect or incomplete.
   b. Information furnished by the client was examined in accordance with generally accepted auditing standards.
   c. All available evidence in support of material assertions on the tax return was examined in accordance with generally accepted auditing standards.
   d. All available evidence in support of material assertions on the tax return was documented in the CPA's working papers.

53. In a computerized system, procedure or problem-oriented language is converted to machine language through a (an)
   a. Interpreter.
   b. Verifier.
   c. Compiler.
   d. Converter.

54. An independent auditor might consider the procedures performed by the internal auditors because
   a. They are employees whose work must be reviewed during substantive testing.
   b. They are employees whose work might be relied upon.
   c. Their work impacts upon the cost/benefit tradeoff in evaluating inherent limitations.
   d. Their degree of independence may be inferred by the nature of their work.

55. A large retail enterprise has established a policy which requires that the paymaster deliver all unclaimed payroll checks to the internal auditing department at the end of each payroll distribution day. This policy was **most** likely adopted in order to
   a. Assure that employees who were absent on a payroll distribution day are **not** paid for that day.
   b. Prevent the paymaster from cashing checks which are unclaimed for several weeks.
   c. Prevent a bona fide employee's check from being claimed by another employee.
   d. Detect any fictitious employee who may have been placed on the payroll.

37. During the course of an audit, independent CPAs are often called upon to give informal advice on many diverse questions. This type of service differs from management advisory services in that this type of service is informal and therefore
   a. The independent CPA does **not** make any warranties with respect to the competence of the extemporaneous advice.
   b. The independent CPA is **not** exposed to liability as a consequence of the extemporaneous advice.
   c. No presumption should exist that all pertinent facts have been identified and considered.
   d. No presumption should exist that the advice will impact upon the operations of the business enterprise.

38. Which of the following accounts should be reviewed by the auditor to gain reasonable assurance that additions to property, plant, and equipment are **not** understated?
   a. Depreciation.
   b. Accounts payable.
   c. Cash.
   d. Repairs.

39. When management refuses to disclose illegal activities which were identified by the independent auditor, the independent auditor may be charged with violating the AICPA Code of Professional Ethics for
   a. Withdrawing from the engagement.
   b. Issuing a disclaimer of opinion.
   c. Failure to uncover the illegal activities during prior audits.
   d. Reporting these activities to the audit committee.

40. An examination of the balance in the accounts payable account is ordinarily **not** designed to
   a. Detect accounts payable which are substantially past due.
   b. Verify that accounts payable were properly authorized.
   c. Ascertain the reasonableness of recorded liabilities.
   d. Determine that all existing liabilities at the balance sheet date have been recorded.

41. Which of the following normally does **not** affect the consistency phrase in the auditor's standard report?
   a. A change in accounting estimate.
   b. A change in accounting principle.
   c. A change in the companies included in combined financial statements.
   d. A correction of an error in principle.

42. An auditor's report on internal accounting control is **least** likely to be issued as a result of a (an)
   a. Audit of the financial statements of a governmental agency.
   b. Review of the annual financial statements of a large corporation.
   c. Special study of a proposed system of internal accounting control.
   d. Special study of related party transactions.

43. In performing an audit, Jackson, CPA, discovers that the professional competence necessary for the engagement is lacking. Jackson informs management of the situation and recommends another local CPA firm, and management engages this other firm. Under these circumstances
   a. Jackson may request compensation from the other CPA firm for any professional services rendered to it in connection with the engagement.
   b. Jackson may accept a referral fee from the other CPA firm.
   c. Jackson has violated the AICPA Code of Professional Ethics because of nonfulfillment of the duty of performance.
   d. Jackson's lack of competence should be construed to be a violation of generally accepted auditing standards.

44. Of the following statements about an internal control system, which one is **not** valid?
   a. No one person should be responsible for the custodial responsibility and the recording responsibility for an asset.
   b. Transactions must be properly authorized before such transactions are processed.
   c. Because of the cost/benefit relationship, a client may apply control procedures on a test basis.
   d. Control procedures reasonably insure that collusion among employees can **not** occur.

45. The following are steps in the audit process:

   I Prepare flowchart
   II Gather exhibits of all documents
   III Interview personnel

The most logical sequence of steps is
   a. I, II, III.
   b. I, III, II.
   c. III, II, I.
   d. II, I, III.

46. Which of the following sampling methods is most useful to auditors when testing for compliance?
   a. Stratified random sampling.
   b. Attribute sampling.
   c. Variable sampling.
   d. Unrestricted random sampling with replacement.

56. Late in December, Tech Products Company sold its marketable securities which had appreciated in value and then repurchased them the same day. The sale and purchase transactions resulted in a large gain. Without the gain the company would have reported a loss for the year. Which of the following statements with respect to the auditor is correct?

a. If the sale and repurchase are disclosed, an unqualified opinion should be rendered.
b. The repurchase transaction is a sham and the auditor should insist upon a reversal or issue an adverse opinion.
c. The auditor should withdraw from the engagement and refuse to be associated with the company.
d. A disclaimer of opinion should be issued.

57. Apex Manufacturing Corporation mass produces eight different products. The controller who is interested in strengthening internal controls over the accounting for materials used in production would be most likely to implement

a. An economic order quantity (EOQ) system.
b. A job order cost accounting system.
c. A perpetual inventory system.
d. A separation of duties among production personnel.

58. The controller of Excello Manufacturing Inc., wants to use ratio analysis to identify the possible existence of idle equipment or the possibility that equipment has been disposed of without having been written off. Which of the following ratios would best accomplish this objective?

a. Depreciation expense/book value of manufacturing equipment.
b. Accumulated depreciation/book value of manufacturing equipment.
c. Repairs and maintenance cost/direct labor costs.
d. Gross manufacturing equipment cost/units produced.

59. Williams & Co., a large international CPA firm, is to have an "external peer review." The peer review will most likely be performed by

a. Employees and partners of Williams & Co. who are **not** associated with the particular audits being reviewed.
b. Audit review staff of the Securities and Exchange Commission.
c. Audit review staff of the American Institute of Certified Public Accountants.
d. Employees and partners of another CPA firm.

60. For reporting purposes, the independent auditor should consider each of the following types of financial presentation to be a financial statement, **except** the statement of

a. Changes in owners' equity.
b. Operations by product lines.
c. Changes in the elements of working capital.
d. Cash receipts and disbursements.

Number 2 (Estimated time —— 15 to 25 minutes)

During the year Strang Corporation began to encounter cash flow difficulties, and a cursory review by management revealed receivable collection problems. Strang's management engaged Stanley, CPA, to perform a special investigation. Stanley studied the billing and collection cycle and noted the following:

The accounting department employs one bookkeeper who receives and opens all incoming mail. This bookkeeper is also responsible for depositing receipts, filing remittance advices on a daily basis, recording receipts in the cash receipts journal, and for posting receipts in the individual customer accounts and the general ledger accounts. There are no cash sales. The bookkeeper prepares and controls the mailing of monthly statements to customers.

The concentration of functions and the receivable collection problems caused Stanley to suspect that a systematic defalcation of customers' payments through a delayed posting of remittances (lapping of accounts receivable) is present. Stanley was surprised to find that no customers complained about receiving erroneous monthly statements.

Required:

Identify the procedures which Stanley should perform to determine whether lapping exists. **Do not discuss deficiencies in the system of internal control.**

Number 3 (Estimated time —— 15 to 25 minutes)

Jones, CPA, who has been engaged to examine the financial statements of Ajax Inc., is about to commence a study and evaluation of Ajax's system of internal control and is aware of the inherent limitations that should be considered.

Required:

a. What are the objectives of a system of internal accounting control?

b. What are the reasonable assurances that are intended to be provided by the system of internal accounting control?

c. When considering the potential effectiveness of any system of internal accounting control what are the inherent limitations that should be recognized?

Number 4 (Estimated time —— 15 to 25 minutes)

The following schedule was prepared by the controller of World Manufacturing Inc., for use by the independent auditors during their examination of World's year-end financial statements. All procedures performed by the audit assistant were noted at the bottom "Legend" section, and it was properly initialed, dated and indexed, and then submitted to a senior member of the audit staff for review. Internal control was reviewed and is considered to be satisfactory.

World Manufacturing, Inc.
MARKETABLE SECURITIES
Year Ended December 31, 1981

Description of Security			*Serial No.*	*Face value of bonds*	*Gen. ledger 1/1*	*Purch. in 1981*	*Sold in 1981*	*Cost*	*Gen. ledger 12/31*	*12/31 market*	*Dividend & Interest* Pay date(s)	*Amt. rec.*	*Accruals 12/31*
Corp. Bonds	*%*	*Yr. Due*											
											1/15	300 b,d	
A	6	91	21-7	10000	9400a				9400	9100	7/15	300 b,d	275
D	4	83	73-0	30000	27500a				27500	26220	12/1	1200 b,d	100
G	9	98	16-4	5000	4000a				4000	5080	8/1	450 b,d	188
Rc	5	85	08-2	70000	66000a		57000b	66000					
Sc	10	99	07-4	100000		100000e			100000	101250	7/1	5000 b,d	5000
					106900	100000	57000	66000	140900	141650		7250	5563
					a,f	f	f	f	f,g	f		f	f
Stocks													
											3/1	750 b,d	
P 1,000 shs. Common			1044		7500a				7500	7600	6/1	750 b,d	
											9/1	750 b,d	
											12/1	750 b,d	250
U 50 shs. Common			8530		9700a				9700	9800	2/1	800 b,d	
											8/1	800 b,d	667
					17200				17200	17400		4600	917
					a,f				f,g	f		f	f

Legends and comments relative to above

- **a** = Beginning balances agreed to 1980 working papers
- **b** = Traced to cash receipts
- **c** = Minutes examined (purchase and sales approved by the board of directors)
- **d** = Agreed to 1099
- **e** = Confirmed by tracing to broker's advice
- **f** = Totals footed
- **g** = Agreed to general ledger

Required:

a. What information that is essential to the audit of marketable securities is missing from this schedule?

b. What are the essential audit procedures that were not noted as having been performed by the audit assistant?

Number 5 (Estimated time —— 15 to 25 minutes)

In order to obtain information that is necessary to make informed decisions, management often calls upon the independent auditor for assistance. This may involve a request that the independent auditor apply certain audit procedures to specific accounts of a company which is a candidate for acquisition and report upon the results. In such an engagement, the agreed-upon procedures may constitute a scope limitation.

At the completion of an engagement performed at the request of Uclean Corporation which was limited in scope as explained above, the following report was prepared by an audit assistant and was submitted to the auditor for review:

To: Board of Directors of Ajax Corporation

We have applied certain agreed-upon procedures, as discussed below, to accounting records of Ajax Corporation, as of December 31, 1981, solely to assist Uclean Corporation in connection with the proposed acquisition of Ajax Corporation.

We have examined the cash in banks and accounts receivable of Ajax Corporation as of December 31, 1981, in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the cash and receivables referred to above are fairly presented as of December 31, 1981, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. We therefore recommend that Uclean Corporation acquire Ajax Corporation pursuant to the proposed agreement.

Signature

Required:

Comment on the proposed report describing those assertions that are:

a. Incorrect or should otherwise be deleted.

b. Missing and should be inserted.

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN BUSINESS LAW

(Commercial Law)

May 7, 1982; 8:30 A.M. to 12:00 M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	110	130
No. 2	15	20
No. 3	15	20
No. 4	15	20
No. 5	15	20
Total	170	210

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers.

3. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 110 to 130 minutes)

Instructions

Select the **best** answer for each of the following items. Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on your total correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

99. The text of the letter from Bridge Builders, Inc., to Allied Steel Co. follows:

> We offer to purchase 10,000 tons of No. 4 steel pipe at today's quoted price for delivery two months from today. Your acceptance must be received in five days.

Bridge Builders intended to create a (an)

a. Option contract.
b. Unilateral contract.
c. Bilateral contract.
d. Joint contract.

Answer Sheet

99. ⓐ ⓑ ● ⓓ

Items to be Answered

1. Three independent sole proprietors decided to pool their resources and form a partnership. The business assets and liabilities of each were transferred to the partnership. The partnership commenced business on September 1, 1981, but the parties did not execute a formal partnership agreement until October 15, 1981. Which of the following is correct?

a. The existing creditors must consent to the transfer of the individual business assets to the partnership.
b. The partnership began its existence on September 1, 1981.
c. If the partnership's duration is indefinite, the partnership agreement must be in writing and signed.
d. In the absence of a partnership agreement specifically covering division of losses among the partners, they will be deemed to share them in accordance with their capital contributions.

2. A question has arisen in determining the partnership's liability for actions taken for and on behalf of a partnership, but which were in fact without express or implied authority. Which of the following actions taken by a general partner will bind the partnership?

a. Renewing an existing supply contract which had previously been negotiated, but which the partners had specifically voted **not** to renew.
b. Submitting a claim against the partnership to binding arbitration.
c. Taking an action which was known by the party with whom he dealt to be in contravention of a restriction on his authority.
d. Signing the firm name as an accommodation comaker on a promissory note not in furtherance of firm business.

3. Stanley is a well known retired movie personality who purchased a limited partnership interest in Terrific Movie Productions upon its initial syndication. Terrific has three general partners, who also purchased limited partnership interests, and 1,000 additional limited partners located throughout the United States. Which of the following is correct?

a. If Stanley permits his name to be used in connection with the business and is held out as a participant in the management of the venture, he will be liable as a general partner.
b. The sale of these limited partnership interests would **not** be subject to SEC registration.
c. This limited partnership may be created with the same informality as a general partnership.
d. The general partners are prohibited from also owning limited partnership interests.

4. Cavendish is a limited partner of Custer Venture Capital. He is extremely dissatisfied with the performance of the general partners in making investments and managing the portfolio. He is contemplating taking whatever legal action may be appropriate against the general partners. Which of the following rights would Cavendish **not** be entitled to assert as a limited partner?

a. To have a formal accounting of partnership affairs whenever the circumstances render it just and reasonable.
b. To have the same rights as a general partner to a dissolution and winding up of the partnership.
c. To have reasonable access to the partnership books and to inspect and copy them.
d. To have himself elected as a general partner by a majority vote of the limited partners in number and amount.

5. The liability of a principal to a third party for the torts of his agent
   a. Can be effectively limited by agreement with the agent.
   b. Can **not** extend to the inclusion of a criminal act committed by the agent.
   c. Is less onerous if the agent is acting for an undisclosed principal.
   d. Is an example of the imposition of liability without fault upon the principal.

6. Harper Company appointed Doe as its agent. It was essential that Harper's identity be kept secret. Therefore, Doe was to act in the capacity of an agent for an undisclosed principal. The duration of the agency was for exactly one year commencing Wednesday of the following week. As a result of this agreement between Harper and Doe, Harper
   a. Is **not** liable on the agency contract unless it is in writing.
   b. Can **not** ratify the unauthorized acts of Doe.
   c. Can rely upon the parol evidence rule to avoid liability to third parties if the contract is in writing.
   d. Can **not** be held liable for torts committed by Doe while acting as an agent.

7. Mathews is an agent for Sears with the express authority to solicit orders from customers in a geographic area assigned by Sears. Mathews has no authority to grant discounts nor to collect payment on orders solicited. Mathews secured an order from Davidson for $1,000 less a 10% discount if Davidson makes immediate payment. Davidson had previously done business with Sears through Mathews but this was the first time that a discount-payment offer had been made. Davidson gave Mathews a check for $900 and thereafter Mathews turned in both the check and the order to Sears. The order clearly indicated that a 10% discount had been given by Mathews. Sears shipped the order and cashed the check. Later Sears attempted to collect $100 as the balance owed on the order from Davidson. Which of the following is correct?
   a. Sears can collect the $100 from Davidson because Mathews contracted outside the scope of his express or implied authority.
   b. Sears can **not** collect the $100 from Davidson because Mathews as an agent with express authority to solicit orders had implied authority to give discounts and collect.
   c. Sears can **not** collect the $100 from Davidson as Sears has ratified the discount granted and payment made to Mathews.
   d. Sears can **not** collect the $100 from Davidson because although Mathews had **no** express or implied authority to grant a discount and collect, Mathews had apparent authority to do so.

8. A court is most likely to disregard the corporate entity and hold shareholders personally liable when
   a. The owner-officers of the corporation do **not** treat it as a separate entity.
   b. A parent corporation creates a wholly owned subsidiary in order to isolate the high risk portion of its business in the subsidiary.
   c. A sole proprietor incorporates his business to limit his liability.
   d. The corporation has elected, under Subchapter S, **not** to pay any corporate tax on its income but, instead, to have the shareholders pay tax on it.

9. Phillips was the principal promoter of the Waterloo Corporation, a corporation which was to have been incorporated not later than July 31, 1981. Among the many things to be accomplished prior to incorporation were the obtaining of capital, the hiring of key executives and the securing of adequate office space. In this connection, Phillips obtained written subscriptions for $1.4 million of common stock from 17 individuals. He hired himself as the chief executive officer of Waterloo at $200,000 for five years and leased three floors of office space from Downtown Office Space, Inc. The contract with Downtown was made in the name of the corporation. Phillips had indicated orally that the corporation would be coming into existence shortly. The corporation did not come into existence through no fault of Phillips. Which of the following is correct?
   a. The subscribers have a recognized right to sue for and recover damages.
   b. Phillips is personally liable on the lease with Downtown.
   c. Phillips has the right to recover the fair value of his services rendered to the proposed corporation.
   d. The subscribers were **not** bound by their subscriptions until the corporation came into existence.

10. Fairwell is executive vice president and treasurer of Wonder Corporation. He was named as a party in a shareholder derivative action in connection with certain activities he engaged in as a corporate officer. In the lawsuit, it was determined that he was liable for negligence in performance of his duties. Fairwell seeks indemnity from the corporation for his liability. The board would like to indemnify him. The articles of incorporation do not contain any provisions regarding indemnification of officers and directors. Indemnification
   a. Is **not** permitted since the articles of incorporation do **not** so provide.
   b. Is permitted only if he is found **not** to have been grossly negligent.
   c. Can **not** include attorney's fees since he was found to have been negligent.
   d. May be permitted by court order despite the fact that Fairwell was found to be negligent.

11. Sandy McBride, president of the Cranston Corporation, inquired about the proper method of handling the expenditures incurred in connection with the recent incorporation of the business and sale of its shares to the public. In explaining the legal or tax treatment of these expenditures, which of the following is correct?

a. The expenditures may be paid out of the consideration received in payment for the shares without rendering such shares not fully paid or assessable.
b. The expenditures are comparable to goodwill and are treated accordingly for nontax and tax purposes.
c. The expenditures must be capitalized and are nondeductible for federal income tax purposes since the life of the corporation is perpetual.
d. The expenditures may be deducted for federal income tax purposes in the year incurred or amortized at the election of the corporation over a five-year period.

12. Bunker's son, Michael, was seeking an account executive position with Harrison, Inc., the largest brokerage firm in the United States. Michael was very independent and wished no interference by his father. The firm, after several weeks deliberation, decided to hire Michael. They made him an offer on April 12, 1982, and Michael readily accepted. Bunker feared that his son would not be hired. Unaware of the fact that his son had been hired, Bunker mailed a letter to Harrison on April 13 in which he promised to give the brokerage firm $50,000 in commission business if the firm would hire his son. The letter was duly received by Harrison and they wish to enforce it against Bunker. Which of the following is correct?

a. Harrison will prevail since the promise is contained in a signed writing.
b. Past consideration is **no** consideration, hence there is **no** contract.
c. Harrison will prevail based upon promissory estoppel.
d. The preexisting legal duty rule applies and makes the promise unenforceable.

13. Foster offered to sell Lebow his garage for $27,000. The offer was in writing and signed by Foster. Foster gave Lebow five days to decide. On the fourth day Foster accepted a better offer from Dilby, who was unaware of the offer to Lebow. Foster subsequently conveyed the property to Dilby. Unaware of the sale to Dilby, Lebow telephoned Foster on the fifth day and unconditionally accepted the offer. Under the circumstances, Lebow

a. Is entitled to specific performance by Foster.
b. Has **no** rights against Foster.
c. Is entitled to damages.
d. Can obtain specific performance by Dilby upon depositing in court the $27,000 he agreed to pay.

14. Paul filed a $20,000 fire loss claim with the Williams Fire Insurance Company. Dickerson, Williams' adjuster, called Paul on the phone and invited him to come to his hotel room to settle the claim. Upon Paul's entry to the room, Dickerson locked the door and placed the key in his pocket. He then accused Paul of having set the building on fire and of having been involved in several previous suspicious fire claims. Dickerson concluded by telling Paul that unless he signed a release in exchange for $500, he would personally see to it that Paul was prosecuted by the company for arson. Visibly shaken by all this, Paul signed the release. Paul has subsequently repudiated the release. The release is **not** binding because of

a. Fraud.
b. Lack of consideration.
c. Undue influence.
d. Duress.

15. On May 1st, Perry Boat Sales sent a letter to James offering to sell James a boat for $4,000. James received the offer the morning of May 3rd. That afternoon, James delivered an acceptance to the telegraph office. Due to an error by the telegraph company, the acceptance was never received by Perry. Which of the following is correct?

a. Perry is bound to a contract even though the telegram of acceptance was never received.
b. Perry is **not** bound to a contract because the telegraph company's error excused him of any responsibility.
c. Perry would be bound to a contract only if James had sent his acceptance by mail.
d. If Perry had sold the boat to Evans, without James' knowledge, before James delivered his acceptance to the telegraph office, Perry would **not** be bound in contract to James.

16. Montrose sent Bilbo a written offer to sell his tract of land located in Majorsville for $50,000. The parties were engaged in a separate dispute. The offer stated that it would be irrevocable for 30 days if Bilbo would promise to refrain from suing Montrose during this time. Bilbo promptly delivered a promise not to sue during the term of the offer and to forego suit if she accepted the offer. Montrose subsequently decided that the possible suit by Bilbo was groundless and therefore phoned Bilbo and revoked the offer ten days after making it. Bilbo mailed an acceptance on the 30th day. Montrose did not reply. Under the circumstances

a. Montrose's offer was supported by consideration, and was irrevocable when accepted.
b. Bilbo's promise was accepted by Montrose by his silence.
c. Montrose's revocation, **not** being in writing, was invalid.
d. Montrose's written offer would be irrevocable even without consideration.

17. Skipper was for several years the principal stockholder, director, and chief executive officer of the Canarsie Grocery Corporation. Canarsie had financial difficulties and an order of relief was filed against it, and subsequently discharged. Several creditors are seeking to hold Skipper personally liable as a result of his stock ownership and as a result of his being an officer-director. Skipper in turn filed with the bankruptcy judge a claim for $1,400 salary due him. Which of the following is correct?

a. Skipper's salary claim will be allowed and he will be entitled to a priority.
b. Skipper has **no** personal liability to the creditors as long as Canarsie is recognized as a separate legal entity.
c. Skipper can **not** personally file a petition in bankruptcy for seven years.
d. Skipper is personally liable to the creditors for Canarsie's losses.

18. Mac, doing business as Mac's Restaurant, has an involuntary petition in bankruptcy filed against him. Which of the following is a correct legal statement regarding such a filing?

a. Mac has the right to controvert the validity of the petition and if Mac is successful, the petition will be dismissed and Mac may recover his costs including a reasonable attorney's fee.
b. The filing of the petition by a majority of the creditors creates a binding presumption that Mac is insolvent.
c. A single creditor may file the petition regardless of the number of creditors if its provable claim exceeds $7,500.
d. A trustee is appointed upon the filing of the petition and is vested by operation of law with the bankrupt's title as of the date of the filing.

19. An audit client is in serious financial trouble. On November 1, 1981, several creditors filed an involuntary petition in bankruptcy. Which of the following is correct?

a. As long as the client generally can meet current debts as they mature, the court will deny relief against the client in a bankruptcy proceeding.
b. If the client creates a new corporation and transfers most of its assets to the newly created corporation, it can avoid bankruptcy.
c. As long as the client's assets, at fair value, exceed its liabilities, the creditors' petition will be denied.
d. Unless the client commits an act of bankruptcy, the creditors can **not** force the client into bankruptcy.

20. The Bankruptcy Reform Act of 1978 provides that certain allowed expenses and claims are entitled to a priority. Which of the following is **not** entitled to such a priority?

a. Claims of governmental units for taxes.
b. Wage claims, but to a limited extent.
c. Rents payable within the four months preceding bankruptcy, but to a limited extent.
d. Unsecured claims for contributions to employee benefit plans, but to a limited extent.

21. Which of the following was a significant reform made in the reorganization provisions of the Bankruptcy Reform Act of 1978?

a. Separate treatment of publicly-held corporations under its provisions.
b. Elimination of the separate and competing procedures contained in the various chapters of the prior Bankruptcy Act.
c. Elimination of participation in bankruptcy reorganizations by the Securities and Exchange Commission.
d. The exclusion from its jurisdiction of partnerships and other noncorporate entities.

22. Clark is a surety on a $100,000 obligation owed by Thompson to Owens. The debt is also secured by a $50,000 mortgage to Owens on Thompson's factory. Thompson is in bankruptcy. Clark has satisfied the debt. Clark is

a. Only entitled to the standing of a general creditor in bankruptcy.
b. A secured creditor to the extent of the $50,000 mortgage and a general creditor for the balance.
c. Entitled to nothing in bankruptcy since this was a risk he assumed.
d. Not entitled to a priority in bankruptcy, even though Owens could validly claim it.

23. Which of the following defenses by a surety will be effective to avoid liability?

a. Lack of consideration to support the surety undertaking.
b. Insolvency in the bankruptcy sense by the debtor.
c. Incompetency of the debtor to make the contract in question.
d. Fraudulent statements by the principal-debtor which induced the surety to assume the obligation and which were unknown to the creditor.

24. Dinsmore & Company was a compensated surety on the construction contract between Victor (the owner) and Gilmore Construction. Gilmore has defaulted and Victor has released Dinsmore for a partial payment and other consideration. The legal effect of the release of Dinsmore is

   a. To release Gilmore as well.
   b. Contingent on recovery from Gilmore.
   c. Binding upon Victor.
   d. To partially release Gilmore to the extent that Dinsmore's right of subrogation has been diminished.

25. In relation to the principal debtor, the creditor and a fellow cosurety, the cosurety is **not** entitled to

   a. Exoneration against the debtor under any circumstances.
   b. A pro-rata contribution by his fellow surety or sureties if he pays the full amount.
   c. Be subrogated to the rights of the creditor upon satisfaction of the debt.
   d. Avoid performance because his cosurety refuses to perform.

26. The Bulk Transfers Article of the Uniform Commercial Code applies to

   a. A general assignment for the benefit of creditors.
   b. A sale of substantially all assets by auction.
   c. A transfer of the bulk of the inventory to settle a lien or other security interest.
   d. A transfer of assets to a receiver.

27. The United States Department of Justice has alleged that Variable Resources, Inc., the largest manufacturer and seller of variable speed drive motors, is a monopolist. It is seeking an injunction ordering divestiture by Variable of a significant portion of its manufacturing facilities. Variable denies it has monopolized the variable speed drive motor market. Which of the following statements is correct insofar as the government's action against Variable is concerned?

   a. The government must prove that Variable is the sole source of a significant portion of the market.
   b. In order to establish monopolization, the government must prove that Variable has at least 75% of the market.
   c. If Variable has the power to control prices or exclude competition, it has monopoly power.
   d. As long as Variable has not been a party to a contract, combination, or conspiracy in restraint of trade, it can not be found to be guilty of monopolization.

28. The Federal Trade Commission Act sets forth a legislative yardstick or standard to be applied with respect to anti-competitive practices. Which of the following is an **incorrect** statement with respect to the Act's scope and application?

   a. The Act's legislative yardstick provides the basis under which the Federal Trade Commission proceeds against violators of the other antitrust laws.
   b. The Act applies not only to goods and wares in interstate commerce, but to services as well.
   c. The Act provides the basis for an action for treble damages by a private party who is adversely affected by a violation of the Act.
   d. The Act permits the Federal Trade Commission to reach violations which are in their incipiency, but which have not yet reached the threshold level of illegality under the Sherman or Clayton Acts.

29. City Utility Company and Suburban Electric Company merged with the permission of the Federal Power Commission. The Department of Justice was apprised of the proposed merger from the beginning. Two years after the consummation of the merger the Department of Justice commenced an action under Section 7 of the Clayton Act and Section 1 of the Sherman Act seeking divestiture. Which of the following is correct?

   a. Public utilities are exempt from the antitrust laws.
   b. The fact that the Department of Justice was aware of the proposed merger and did nothing precludes it from obtaining an injunction at this late date.
   c. A merger can **not** be illegal under both the Sherman and Clayton Acts.
   d. Injunctive relief ordering divestiture is a proper form of relief for the Department of Justice to seek.

30. Jackson Corporation is engaging in a widespread price fixing arrangement with several of its leading competitors. Which of the following is correct?

   a. Only the federal government can obtain injunctive relief.
   b. The agreement will **not** be found to be illegal if the parties can show they are merely meeting competition.
   c. If one of the parties to the price fixing arrangement sues Jackson for treble damages for certain breaches of the agreement, relief will be denied.
   d. The officers of Jackson can **not** be prosecuted and found guilty of violating the antitrust law as long as they are acting solely for and on behalf of the corporation.

31. Gould Machinery builds bulldozers. Prior to 1981, it sold on credit a substantial amount of equipment to Mace Contractors. Mace went into bankruptcy in 1981. In order to protect its investment, Gould took over the business of Mace. Erhart Contractors now complains that the acquisition harms its business, on the ground that its business would have improved had not Gould entered the market as a competitor. Erhart can

   a. Not recover damages under the antitrust laws.
   b. Recover treble damages.
   c. Recover only its actual damages.
   d. Obtain injunctive relief ordering divestiture.

32. Darby Corporation manufactures a patented and trademarked, high quality, expensive product. It has discovered that certain disreputable discount stores have been using it as a loss leader. Darby has commenced a rigorous enforcement of its suggested minimum resale price in order to protect its product. Under the circumstances, Darby is

   a. Guilty of price discrimination.
   b. Guilty of per se illegal price fixing.
   c. Not guilty of any violation of the antitrust laws since retail price maintenance is legal.
   d. Not guilty since Darby may validly set a minimum price beneath which a patented product may not be sold.

33. The Marvel Tire Company entered into agreements with its retailers whereby they agreed not to sell Marvel tires beneath the minimum prices determined by Marvel. In exchange for this agreement, Marvel promised not to sell tires at retail in the retailers' respective territories. The agreement did not preclude the retailers from selling competing brands of tires. The agreement is

   a. An exception to the price fixing provision of the Sherman Act because Marvel has given up the right to sell in the various territories.
   b. Illegal even though the minimum prices are reasonable.
   c. Legal since the retailers are permitted to sell the competing brands at any price they choose.
   d. Legal if the tires are sold under Marvel's exclusive trademark.

34. Under the Fair Labor Standards Act, certain employment of children is considered oppressive and is prohibited. Which of the following is **not** a legal exception to the Act?

   a. Employment in agriculture outside of school hours.
   b. Employment of children under sixteen by a parent.
   c. Newspaper delivery.
   d. After school part-time work in the fast-food industry.

35. The following instrument has been received by your client:

> October 15, 1981
>
> To: Bill Souther
> Rural Route 1
> Waverly, Iowa
>
> Pay to the order of James Olson six hundred dollars.
>
> Robert Smythe
> Robert Smythe

Which of the following is correct?

   a. The instrument is payable on demand.
   b. The instrument is a negotiable note.
   c. As Bill Souther is the drawer, he is primarily liable on the instrument.
   d. As Bill Souther is the drawee, he is secondarily liable on the instrument.

36. Industrial Factors, Inc., discounted a $4,000 promissory note, payable in two years, for $3,000. It paid $1,000 initially and promised to pay the balance ($2,000) within 30 days. Industrial paid the balance within the 30 days, but before doing so learned that the note had been obtained originally by fraudulent misrepresentation in connection with the sale of land which induced the maker to issue the note. For what amount will Industrial qualify as a holder in due course?

   a. None because the 25% discount is presumptive or prima facie evidence that Industrial is **not** a holder in due course.
   b. $1,000.
   c. $3,000.
   d. $4,000.

37. Although the scope of the Uniform Commercial Code is broad insofar as inclusion of instruments within the definition of commercial paper, it excludes certain instruments from its coverage. Which of the following is **not** commercial paper?

   a. A promissory note payable 30 days after presentment for payment.
   b. A draft which is an order to pay.
   c. A negotiable certificate of deposit issued by a bank.
   d. An investment security which is payable to bearer.

38. Cindy Lake is a holder in due course of a negotiable promissory note for $1,000. Which of the following defenses of the maker may be validly asserted against her?

a. A total failure of consideration on the part of the party to whom it was issued.
b. A wrongful filling in of the amount on the instrument by the party to whom it was issued.
c. Nonperformance of a condition precedent to its transfer by the party to whom it was issued.
d. Infancy of the maker to the extent that it is a defense to a simple contract.

39. Franklin sold her grain business to Hobson for $150,000 and received a check drawn on Farmer's Bank for that amount. In addition, she entered into a contract for the purchase of a ranch for the same amount. The closing on the ranch is to take place in five days. The sales contract regarding the ranch requires payment by cash, by buyer's certified check, or by certified check payable to the buyer's order and indorsed to the seller. Franklin intends to have Hobson's check certified by Farmer's Bank and use it as payment. Which of the following is correct?

a. If the bank refuses to certify the check it has been dishonored.
b. If Hobson's account has sufficient funds to honor the check, Franklin has the right to have it certified.
c. Certification by the bank will discharge Hobson from liability as the drawer.
d. Only Hobson can obtain certification of the check.

40. Hoover is a holder in due course of a check which was originally payable to the order of Nelson or bearer and has the following indorsements on its back:

> *Nelson*
> Pay to the order of Maxwell
> *Duffy*
> Without Recourse
> *Maxwell*
> *Howard*

Which of the following statements about the check is correct?

a. It was originally order paper.
b. It was order paper in Howard's hands.
c. Maxwell's signature was **not** necessary for it to be negotiated.
d. Presentment for payment must be made within seven days after indorsement to hold an indorser liable.

41. Your client, Ensign Factors Corporation, has purchased the trade acceptance shown below from Mason Art Productions, Inc. It has been properly indorsed in blank on the back by Mason.

> October 15, 1981
>
> Adams Wholesalers, Inc.
> 49 Buena Vista Avenue
> Santa Monica, California
>
> Pay to the order of Mason Art Productions, Inc., ten thousand and 00/100 dollars ($10,000.00).
>
> *Gilda Loucksi*
> Gilda Loucksi, President
> Mason Art Productions, Inc.
>
> Accepted *October 24, 1981*
> Adams Wholesalers, Inc.
>
> By *Charles Lurch, President*

As to the rights of Ensign, which of the following is correct?

a. The instrument is nonnegotiable, hence Ensign is an assignee.
b. Until acceptance, Mason had primary liability on the instrument.
c. After acceptance by Adams Wholesalers, Adams is primarily liable and Mason is secondarily liable.
d. After acceptance by Adams, Mason is primarily liable, and Adams is secondarily liable.

42. Balquist sold a negotiable instrument payable to her order to Farley. In transferring the instrument to Farley, she forgot to indorse it. Accordingly

a. Farley qualifies as a holder in due course.
b. Farley has a specifically enforceable right to obtain Balquist's unqualified indorsement.
c. Farley obtains a better right to payment of the instrument than Balquist had.
d. Once the signature of Balquist is obtained, Farley's rights as a holder in due course relate back to the time of transfer.

43. Which of the following provisions contained in an otherwise negotiable instrument will cause it to be non-negotiable?
  a. It is payable in Mexican pesos.
  b. It contains an unrestricted acceleration clause.
  c. It grants to the holder an option to purchase land.
  d. It is limited to payment out of the entire assets of a partnership.

44. While auditing the common stock ledger of Sims Corporation a CPA uncovers the following situation. An investor has purchased a certificate representing 500 shares of common stock of the Sims Corporation from a former clerk of the corporation. It was the duty of the clerk to prepare stock certificates from a supply of blanks for signature of the corporate secretary. The clerk forged the corporate secretary's signature on a bearer certificate and delivered the certificate for value to the investor who did not have notice of the forgery and who now demands a reissued certificate in the investor's name from the corporation. The corporation asserts that it has no liability to reissue a certificate in the name of the investor and that the investor's bearer certificate is null and void. Which of the following is correct?
  a. The certificate is valid and the investor is entitled to a reissued certificate.
  b. The certificate issued is invalid and the corporation has **no** liability to reissue.
  c. An appropriate recourse of the investor is to sue the corporation and clerk for dollar damages and to sue the clerk for the crime of forgery.
  d. The corporation is required to reissue a certificate only if appropriately compensated by the investor.

45. Wilberforce & Company has in its possession certain securities which it took in good faith and for value from Dunlop. An adverse claim or defense has been asserted against the securities. Which of the following warranties may Wilberforce validly assert against Dunlop, its prior transferor?
  a. There is **no** defect in the prior chain of title.
  b. The securities are genuine and have **not** been materially altered.
  c. There is **no** defect which might impair the validity of the securities.
  d. Dunlop will defend the purchasers' title from adverse claim or defects which would impair the validity of the securities.

46. Mansfield Financial lends money on the strength of negotiable warehouse receipts. Its policy is always to obtain a perfected security interest in the receipts against the creditors of the borrowers and to maintain it until the loan has been satisfied. Insofar as this policy is concerned, which of the following is correct?
  a. Mansfield can **not** transfer the warehouse receipts to another lending institution without the debtor's consent.
  b. Relinquishment of the receipts is **not** permitted under any circumstances without the loss of the perfected security interest in them.
  c. Mansfield has a perfected security interest in goods which the receipts represent.
  d. If the receipts are somehow wrongfully duly negotiated to a holder, Mansfield's perfected security interest will **not** be prejudiced.

47. A claim has been made by Donnegal to certain goods in your client's possession. Donnegal will be entitled to the goods if it can be shown that Variance, the party from whom your client purchased the goods, obtained them by
  a. Deceiving Donnegal as to his identity at the time of the purchase.
  b. Giving Donnegal his check which was later dishonored.
  c. Obtaining the goods from Donnegal by fraud, punishable as larceny under criminal law.
  d. Purchasing goods which had been previously stolen from Donnegal.

48. Johnstone Hardware Company sold a $450 drill press to Markum for use in his home workshop. Markum paid 20% initially and promised to pay the balance in monthly installments over a period of one year. Johnstone took a purchase money security interest in the drill press to secure payment. Markum promised not to sell or otherwise transfer the drill press without Johnstone's consent. Johnstone did not file a financing statement in connection with the transaction. Markum subsequently found himself hard pressed to make the payments and defaulted. He then sold the drill press to his neighbor Harper for $250 without disclosing Johnstone's interest and without Johnstone's consent. Under the circumstances
  a. The security agreement need not be in writing and signed in order to be valid since the purchase price of the drill press is less than $500.
  b. No one can obtain superior rights to the drill press in that transfer of the press was prohibited without Johnstone's consent.
  c. Johnstone's security interest is perfected against the other creditors of Markum, but not against Harper.
  d. Harper would take the drill press free of Johnstone's security interest even if Johnstone had filed.

49. The Uniform Commercial Code contains numerous provisions relating to the rights and remedies of the parties upon default. With respect to a buyer, these provisions may
    a. Not be varied even with the agreement of the buyer.
    b. Only be varied if the buyer is apprised of the fact and initials the variances in the agreement.
    c. Not be varied insofar as they require the secured party to account for any surplus realized on the disposition of collateral securing the obligation.
    d. All be varied by agreement as long as the variances are not manifestly unreasonable.

50. Dix Laboratories, Ltd., manufactures medical equipment for sale to medical institutions and retailers. Dix also sells directly to consumers in its wholly-owned retail outlets. Dix has created a subsidiary, Dix Finance Corporation, for the purpose of financing the purchase of its products by the various customers. In which of the following situations does Dix Finance **not** have to file a financing statement to perfect its security interest against competing creditors in the equipment sold by Dix?
    a. Sales made to consumers who purchase for their own personal use.
    b. Sales made to retailers who in turn sell to buyers in the ordinary course of business.
    c. Sales made to any buyer when the equipment becomes a fixture.
    d. Sales made to medical institutions.

51. A condition in a contract for the purchase of real property which makes the purchaser's obligation dependent upon his obtaining a given dollar amount of conventional mortgage financing
    a. Can be satisfied by the seller if the seller offers the buyer a demand loan for the amount.
    b. Is a condition subsequent.
    c. Is implied as a matter of law.
    d. Requires the purchaser to use reasonable efforts to obtain the financing.

52. Park purchased Marshall's department store. At the closing, Park delivered a certified check for the balance due and Marshall gave Park a warranty deed with full covenants to the property. The deed
    a. Must be recorded to be valid between the parties.
    b. Must recite the actual consideration given by Park.
    c. Must be in writing and contain the signature of both parties duly witnessed.
    d. Usually represents an exclusive integration of the duties of the seller.

53. Fulcrum Enterprises, Inc., contracted to purchase a four acre tract of land from Devlin as a site for its proposed factory. The contract of sale is silent on the type of deed to be received by Fulcrum and does not contain any title exceptions. The title search revealed that there are 51 zoning laws which affect Fulcrum's use of the land and that back taxes are due. A survey revealed a stone wall encroaching upon a portion of the land Devlin is purporting to convey. A survey made 23 years ago also had revealed the wall. Regarding the rights and duties of Fulcrum, which of the following is correct?
    a. Fulcrum is entitled to a warranty deed with full covenants from Devlin at the closing.
    b. The existence of the zoning laws above will permit Fulcrum to avoid the contract.
    c. Fulcrum must take the land subject to the back taxes.
    d. The wall results in a potential breach of the implied warranty of marketability.

54. Linderman purchased a tract of land from Noteworthy for $250,000. Noteworthy revealed the fact that there was an existing first mortgage of $100,000 on the property which would be satisfied out of the proceeds of the sale. Effective Title Company's title search and policy revealed only the first mortgage. Noteworthy did not reveal that there was a $50,000 unrecorded second mortgage on the property held by his father, Vincent. The first mortgage was satisfied at the closing and Linderman presumed he had clear title to the property. A month after the closing, Vincent appeared and claimed that Linderman was obligated to pay the principal and interest on the mortgage he held. Noteworthy has fled the jurisdiction. As among Linderman, Vincent, and Effective, which of the following is correct?
    a. Vincent will prevail since he had a valid second mortgage.
    b. Effective must pay on its title policy since it is an insurer.
    c. Linderman's failure to obtain an affidavit from Noteworthy representing that there was no other mortgage outstanding will result in his taking subject to the Vincent mortgage.
    d. Linderman will take free of the Vincent mortgage.

55. Assuming that a given trust indenture is silent on the point, the trustee has certain rights and duties as a matter of law. The trustee
    a. Has a fiduciary duty to the trust but **not** to the beneficiaries.
    b. Is **not** entitled to commissions unless so provided.
    c. Can elect to terminate the trust as long as the beneficiaries unanimously concur.
    d. Must act in a competent, nonnegligent manner, or he may face removal.

56. Wayne & Company, CPAs, was engaged by Harding, the trustee of the Timmons Testamentary Trust. The will creating the Timmons Trust gave Harding wide discretion with respect to the investment of the trust principal but was silent on the question of the allocation of receipts and charges to principal or income. Among the assets invested in by Harding is a $500,000 annuity and a $50,000 limited partnership interest in an offshore investment limited partnership. The partnership has reported a $40,000 loss for the year. Regarding the trust in general and the limited partnership loss allocation in particular, which of the following is correct?

a. It is against public policy to permit the investment by the trustee in the offshore investment limited partnership.
b. Since the trust is silent on the allocation question, Harding has wide discretion in making allocations.
c. The loss attributable to the offshore partnership is allocable equally to principal and income.
d. The receipts from the $500,000 annuity must be apportioned between principal and income.

57. Martins created an irrevocable fifteen-year trust for the benefit of his minor children. At the end of the fifteen years, the principal reverts to Martins. Martins named the Bloom Trust Company as trustee and provided that Bloom would serve without the necessity of posting a bond. In understanding the trust and rules applicable to it, which of the following is correct?

a. If Martins dies ten years after creation of the trust, it is automatically revoked and the property is distributed to the beneficiaries of his trust upon their attaining age 21.
b. Martins may revoke the trust after eleven years, since he created it, and the principal reverts to him at the expiration of the fifteen years.
c. The facts indicate that the trust is a separate legal entity for both tax and non-tax purposes.
d. The trust is **not** a separate legal entity for federal tax purposes.

58. The coinsurance feature of property insurance

a. Is fixed at a minimum of 80% by law.
b. Prevents the insured from insuring for a minimal amount and recovering in full for such losses.
c. Precludes the insured from insuring for less than the coinsurance percentage.
d. Is an additional refinement of the insurable interest requirement.

59. Tedland Trading Corporation insured its 17 automobiles for both liability and collision. Milsap, one of its salesmen, was in an automobile accident while driving a company car on a sales trip. The facts clearly reveal that the accident was solely the fault of Williams, the driver of the other car. Milsap was seriously injured, and the automobile was declared a total loss. The value of the auto was $3,000. Which of the following is an **incorrect** statement regarding the rights and liabilities of Tedland, its insurer, Milsap and Williams?

a. Tedland's insurer must defend Tedland against any claims by Milsap or Williams.
b. Tedland's insurer has **no** liability whatsoever since the accident was the result of Williams' negligence.
c. Milsap has an independent action against Williams for the injuries caused by Williams' negligence.
d. Tedland's insurer is liable for $3,000, less any deductible, on the collision policy, but will be subrogated to Tedland's rights.

60. Which of the following is an **incorrect** statement regarding the insurable interest requirement as it applies to property insurance?

a. It is used to determine the amount of recovery to be awarded the insured.
b. It need **not** necessarily be present at the inception of the policy so long as it is present at the time of the loss.
c. One of its functions is to prevent recovery by those who have **no** economic interest in the property insured.
d. It can be waived by the parties so long as both are fully competent to contract.

Number 2 (Estimated time —— 15 to 20 minutes)

Various Enterprises Corporation is a medium sized conglomerate listed on the American Stock Exchange. It is constantly in the process of acquiring smaller corporations and is invariably in need of additional money. Among its diversified holdings is a citrus grove which it purchased eight years ago as an investment. The grove's current fair market value is in excess of $2 million. Various also owns 800,000 shares of Resistance Corporation which it acquired in the open market over a period of years. These shares represent a 17% minority interest in Resistance and are worth approximately $2½ million. Various does its short-term financing with a consortium of banking institutions. Several of these loans are maturing; in addition to renewing these loans, it wishes to increase its short-term debt from $3 to $4 million.

In light of the above, Various is considering resorting to one or all of the following alternatives in order to raise additional working capital.

- An offering of 500 citrus grove units at $5,000 per unit. Each unit would give the purchaser a 0.2% ownership interest in the citrus grove development. Various would furnish management and operation services for a fee under a management contract and net proceeds would be paid to the unit purchasers. The offering would be confined almost exclusively to the state in which the groves are located or in the adjacent state in which Various is incorporated.

- An increase in the short-term borrowing by $1 million from the banking institution which currently provides short-term funds. The existing debt would be consolidated, extended and increased to $4 million and would mature over a nine month period. This would be evidenced by a short-term note.

- Sale of the 17% minority interest in Resistance Corporation in the open market through its brokers over a period of time and in such a way so as to minimize decreasing the value of the stock. The stock is to be sold in an orderly manner in the ordinary course of the broker's business.

Required: Answer the following, setting forth reasons for any conclusions stated.

In separate paragraphs discuss the impact of the registration requirements of the Securities Act of 1933 on each of the above proposed alternatives.

Number 3 (Estimated time —— 15 to 20 minutes)

Part a. Ralph Sharp, CPA, has audited the Fargo Corporation for the last ten years. It was recently discovered that Fargo's top management has been engaged in some questionable financial activities since the last audited financial statements were issued.

Subsequently, Fargo was sued in state court by its major competitor, Nuggett, Inc. In addition, the SEC commenced an investigation against Fargo for possible violations of the federal securities laws.

Both Nuggett and the SEC have subpoenaed all of Sharp's workpapers relating to his audits of Fargo for the last ten years. There is no evidence either that Sharp did anything improper or that any questionable financial activities by Fargo occurred prior to this year.

Sharp estimates that the cost for his duplicate photocopying of all of the workpapers would be $25,000 (approximately one year's audit fee). Fargo has instructed Sharp not to turn over the workpapers to anyone.

Required: Answer the following, setting forth reasons for any conclusions stated.

1. If Sharp practices in a state which has a statutory accountant-client privilege, may the state's accountant-client privilege be successfully asserted to avoid turning over the workpapers to the SEC?
2. Assuming Sharp, with Fargo's permission, turns over to Nuggett workpapers for the last two audit years, may the state's accountant-client privilege be successfully asserted to avoid producing the workpapers for the first eight years?
3. Other than asserting an accountant-client privilege, what major defenses might Sharp raise against the SEC and Nuggett in order to resist turning over the subpoenaed workpapers?

Part b. Pelham & James, CPAs, were retained by Tom Stone, sole proprietor of Stone Housebuilders, to compile Stone's financial statements. Stone advised Pelham & James that the financial statements would be used in connection with a possible incorporation of the business and sale of stock to friends. Prior to undertaking the engagement, Pelham & James were also advised to pay particular attention to the trade accounts payable. They agreed to use every reasonable means to determine the correct amount.

At the time Pelham & James were engaged, the books and records were in total disarray. Pelham & James proceeded with the engagement applying all applicable procedures for compiling financial statements. They failed however, to detect and disclose in the financial statements Stone's liability for certain unpaid bills. Documentation concerning those bills was available for Pelham & James' inspection had they looked. This omission led to a material understatement ($60,000) of the trade accounts payable.

Pelham & James delivered the compiled financial statements to Tom Stone with their compilation report which indicated that they did not express an opinion or any other assurance regarding the financial statements. Tom Stone met with two prospective investors, Dickerson and Nichols. At the meeting, Pelham & James stated that they were confident that the trade accounts payable balance was accurate to within $8,000.

Stone Housebuilders was incorporated. Dickerson and Nichols, relying on the financial statements, became stockholders along with Tom Stone. Shortly thereafter, the understatement of trade accounts payable was detected. As a result, Dickerson and Nichols discovered that they had paid substantially more for the stock than it was worth at the time of purchase.

Required: Answer the following, setting forth reasons for any conclusions stated.

Will Pelham & James be found liable to Dickerson and Nichols in a common law action for their damages?

Number 4 (Estimated time —— 15 to 20 minutes)

Part a. Craig Manufacturing Company needed an additional supply of water for its plant. Consequently, Craig advertised for bids. Shaw Drilling Company submitted the lowest bid and was engaged to drill a well. After a contract had been executed and drilling begun, Shaw discovered that the consistency of the soil was much harder than had been previously encountered in the surrounding countryside. In addition, there was an unexpected layer of bedrock. These facts, unknown to both Craig and Shaw when the contract was signed, significantly increased the cost of performing the contract. Therefore, Shaw announced its intention to abandon performance unless it was assured of recovering its cost. Craig agreed in writing to pay the amount of additional cost if Shaw would continue to drill and complete the contract. Shaw, on the strength of this written promise, completed the job. The additional cost amounted to $10,000 which Shaw now seeks to recover. Craig refuses to pay and asserts that the additional burden was a part of the risk assumed and that the only reason it agreed to pay the additional amount was that it needed the additional water supply on time as agreed.

Shaw has commenced legal action to recover the $10,000 in dispute. Craig denies liability.

Required: Answer the following, setting forth reasons for any conclusions stated.

1. What is the legal liability of Craig as a result of the facts described above?

2. Suppose the contract had been for the purchase of computer parts and the manufacturer had encountered a significant increase in labor cost which it wished to pass on to the purchaser. Would the purchaser's subsequent written promise to make an additional payment have been binding?

Part b. Ogilvie is a wealthy, prominent citizen of Clarion County. Most of his activities and his properties are located in Vista City, the county seat. Among his holdings are large tracts of farmland located in the outlying parts of Clarion. He has not personally examined large portions of his holdings due to the distance factor and the time it would take. One of his agents told him that 95% of the land was fertile and could be used for general farming. Farber, a recent college graduate who inherited a modest amount of money decided to invest in farmland and raise avocados. He had read certain advertising literature extolling the virtues of avocado farming as an investment. He called upon Ogilvie and discussed the purchase of his land. In the process, Ogilvie praised his land as a great investment for the future. He stated that the land was virtually all splendid farmland and that it would be suitable for avocado growing. Farber entered into a contract of purchase and made a deposit of 10% on the purchase price.

On the eve of the closing, Farber learned of the presence of extensive rock formations at or near the surface of the land. These rock formations make avocado growing virtually impossible but still permit limited use for some other types of farming. These rock formations are partially visible and could have been seen if Farber had examined the property. They cover approximately 25% of the land.

Accordingly, Farber refused to perform the original contract and demanded that the unsuitable 25% of the land be severed from the contract and the price diminished accordingly.

Ogilvie asserted that "a contract is a contract" and that the doctrine of caveat emptor is applicable in the sale of land. Specifically, he stated that he committed no fraud because:

1. Nothing he said was a statement of fact. It was opinion or puffing.

2. His statements were not material since most of the land is okay, and the balance can be used for some types of farming.

3. He had not lied since he had no knowledge of the falsity of his statements.

4. Farber could have and should have inspected and by failing to do so he was negligent and cannot recover.

Farber then commenced legal proceedings against Ogilvie based on fraud.

Required: Answer the following, setting forth reasons for any conclusions stated.

In separate paragraphs, discuss the validity of each of Ogilvie's four assertions that he committed no fraud.

Number 5 (Estimated time —— 15 to 20 minutes)

Part a. Sure Rain Apparel, Inc., manufactures expensive, exclusive rain apparel. One model is very popular and sold widely throughout the United States. About six months after their initial sale to distributors, Sure started receiving complaints that there was a noticeable fading of the color of the material. Many of the distributors seek to return the goods, recover damages, or both. Sure denies liability on the following bases: (1) there was an "Act of God," (2) there was no breach of warranty since the fading was to be expected in any event, and (3) any and all warranty protection was disclaimed unless expressly stated in the contract.

The contract contained the following provisions relating to warranty protection:

First:	The manufacturer warrants that the material used to make the raincoats is 100% Egyptian long fiber cotton.
Second:	The manufacturer guarantees the waterproofing of the raincoat for one year if the directions as to dry cleaning are followed.
Third:	There are no other express warranties granted by the seller, except those indicated above. This writing is intended as a complete statement and integration of all express warranty protection.
Fourth:	The manufacturer does not purport to give any implied warranty of merchantability in connection with this sale. The express warranties above enumerated are granted in lieu thereof.
Fifth:	There are no warranties which extend beyond the description above.

The fourth and fifth provisions were conspicuous and initialed by the buyers.

Several buyers have commenced legal actions against Sure based upon implied warranties and express oral warranties made prior to the execution of the contract.

Required: Answer the following, setting forth reasons for any conclusions stated.

Is Sure liable for breach of warranty?

Part b. Nielson Wholesalers, Inc., ordered 1,000 scissors at $2.50 a pair from Wilmot, Inc., on February 1, 1982. Delivery was to be made not later than March 10. Wilmot accepted the order in writing on February 4. The terms were 2/10, net/30, F.O.B. seller's loading platform in Baltimore. Due to unexpected additional orders and a miscalculation of the backlog of orders, Wilmot subsequently determined that it could not perform by March 10. On February 15, Wilmot notified Nielson that it would not be able to perform, and cancelled the contract. Wilmot pleaded a reasonable mistake and impossibility of performance as its justification for cancelling. At the time the notice of cancellation was received, identical scissors were available from other manufacturers at $2.70. Nielson chose not to purchase the 1,000 scissors elsewhere, but instead notified Wilmot that it rejected the purported cancellation and would await delivery as agreed. Wilmot did not deliver on March 10, by which time the price of the scissors had risen to $3.00 a pair. Nielson is seeking to recover damages from Wilmot for breach of contract.

Required: Answer the following, setting forth reasons for any conclusions stated.

1. Will Nielson prevail and, if so, how much will it recover?
2. Would Nielson be entitled to specific performance under the circumstances?
3. Assuming that Wilmot discovers that Nielson was insolvent, will this excuse performance?

Uniform Certified Public Accountant Examination

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN ACCOUNTING THEORY

(Theory of Accounts)

May 7, 1982; 1:30 to 5:00 P.M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	90	110
No. 2	15	25
No. 3	15	25
No. 4	15	25
No. 5	15	25
Total	150	210

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers.

3. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 90 to 110 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of issues in accounting.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on your total correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

99. The financial statement which summarizes the financial position of a company is the
   a. Income statement.
   b. Balance sheet.
   c. Statement of changes in financial position.
   d. Retained earnings statement.

Answer Sheet

99. ⓐ ● ⓒ ⓓ

Items to be Answered

1. A machine with a four-year estimated useful life and an estimated fifteen-percent salvage value was acquired on January 1. Would depreciation expense using the sum-of-the-years-digits method of depreciation be higher or lower than depreciation expense using the double-declining-balance method of depreciation in the first and second years?

	First year	*Second year*
a.	Higher	Higher
b.	Higher	Lower
c.	Lower	Higher
d.	Lower	Lower

2. When reporting the loss on disposal of a segment of a business which is to be abandoned, an estimated amount for operating losses during the phase-out period should
   a. Be included in the income statement as part of the loss on disposal of the discontinued segment.
   b. Be included in the income statement as part of the income (loss) from operations of the discontinued segment.
   c. Be included in the income statement as part of the income (loss) from continuing operations.
   d. Not be included in the income statement.

3. On January 1, 1975, an intangible asset with a thirty-five year estimated useful life was acquired. On January 1, 1980, a review was made of the estimated useful life, and it was determined that the intangible asset had an estimated useful life of forty-five more years. As a result of the review
   a. The original cost at January 1, 1975, should be amortized over a fifty-year life.
   b. The original cost at January 1, 1975, should be amortized over the remaining thirty-year life.
   c. The unamortized cost at January 1, 1980, should be amortized over a forty-year life.
   d. The unamortized cost at January 1, 1980, should be amortized over a thirty-five year life.

4. For which of the following transactions would the use of the present value of an annuity due concept be appropriate in calculating the present value of the asset obtained or liability owed at the date of incurrence?
   a. A capital lease is entered into with the initial lease payment due one month subsequent to the signing of the lease agreement.
   b. A capital lease is entered into with the initial lease payment due upon the signing of the lease agreement.
   c. A ten-year 8% bond is issued on January 2 with interest payable semi-annually on July 1 and January 1 yielding 7%.
   d. A ten-year 8% bond is issued on January 2 with interest payable semi-annually on July 1 and January 1 yielding 9%.

5. A particular warranty obligation is probable and the amount of the loss can be reasonably estimated. The particular parties that will make claims under the warranty are not identifiable. An estimated loss contingency should then be
   a. Classified as an appropriation of retained earnings.
   b. Neither accrued nor disclosed.
   c. Disclosed but **not** accrued.
   d. Accrued.

6. When the interest payment dates of a bond are May 1 and November 1, and a bond issue is sold on June 1, the amount of cash received by the issuer will be
   a. Increased by accrued interest from June 1 to November 1.
   b. Increased by accrued interest from May 1 to June 1.
   c. Decreased by accrued interest from June 1 to November 1.
   d. Decreased by accrued interest from May 1 to June 1.

7. The double extension method and the link-chain method are two variations of which of the following inventory cost flow methods?
   a. Moving average.
   b. FIFO.
   c. Dollar value LIFO.
   d. Conventional (lower of cost or market) retail.

8. When the cash proceeds from a bond issued with detachable stock purchase warrants exceeds the sum of the par value of the bonds and the fair value of the warrants, the excess should be credited to
   a. Additional paid-in capital.
   b. Retained earnings.
   c. Premium on bonds payable.
   d. Detachable stock warrants outstanding.

9. The excess of the fair value of the consideration received over the stated value of no par common stock should be credited to
   a. A liability account.
   b. Common stock.
   c. Additional paid-in capital.
   d. Retained earnings.

10. The dollar amount of total stockholders' equity remains the same when there is a (an)
   a. Issuance of preferred stock in exchange for convertible debentures.
   b. Issuance of nonconvertible bonds with detachable stock purchase warrants.
   c. Declaration of a stock dividend.
   d. Declaration of a cash dividend.

11. When treasury stock is purchased for more than its par value, treasury stock is debited for the purchase price under which of the following methods?

	Cost method	*Par value method*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

12. A subsidiary may be acquired by issuing common stock in a pooling of interests transaction or by paying cash in a purchase transaction. Which of the following items would be reported in the consolidated financial statements at the same amount regardless of the accounting method used?
   a. Minority interest.
   b. Goodwill.
   c. Retained earnings.
   d. Capital stock.

13. Which of the following is issued to shareholders by a corporation as evidence of the ownership of rights to acquire its unissued or treasury stock?
   a. Stock options.
   b. Stock warrants.
   c. Stock dividends.
   d. Stock subscriptions.

14. Which of the following is considered a pervasive constraint by Statement of Financial Accounting Concepts No. 2?
   a. Benefits/costs.
   b. Conservatism.
   c. Timeliness.
   d. Verifiability.

15. According to Statement of Financial Accounting Concepts No. 2, an interim earnings report is expected to have which of the following?

	Predictive value	*Feedback value*
a.	No	No
b.	Yes	Yes
c.	Yes	No
d.	No	Yes

16. Uncertainty and risks inherent in business situations should be adequately considered in financial reporting. This statement is an example of the concept of
   a. Conservatism.
   b. Completeness.
   c. Neutrality.
   d. Representational faithfulness.

17. In an arm's-length transaction, Company A and Company B exchanged nonmonetary assets with no monetary consideration involved. The exchange did culminate an earning process for both Company A and Company B, and the fair values of the nonmonetary assets were both clearly evident. The accounting for the exchange should be based on the
   a. Fair value of the asset surrendered.
   b. Fair value of the asset received.
   c. Recorded amount of the asset surrendered.
   d. Recorded amount of the asset received.

18. Ownership of 51 percent of the outstanding voting stock of a company would usually result in
   a. The use of the cost method.
   b. The use of the lower of cost or market method.
   c. A pooling of interests.
   d. A consolidation.

19. The completed-contract method of accounting for long-term construction-type contracts is preferable when
   a. A contractor is involved in numerous projects.
   b. The contracts are of a relatively long duration.
   c. Estimates of costs to complete and extent of progress toward completion are reasonably dependable.
   d. Lack of dependable estimates or inherent hazards cause forecasts to be doubtful.

20. In determining primary earnings per share, dividends on nonconvertible cumulative preferred stock should be
   a. Deducted from net income whether declared or not.
   b. Deducted from net income only if declared.
   c. Added back to net income whether declared or not.
   d. Disregarded.

21. In a period of rising prices, the use of which of the following inventory cost flow methods would result in the highest cost of goods sold?
   a. FIFO.
   b. LIFO.
   c. Weighted average cost.
   d. Moving average cost.

22. In a periodic inventory system which uses the FIFO cost flow method, the cost of goods available for sale is net purchases
   a. Plus the ending inventory.
   b. Plus the beginning inventory.
   c. Minus the ending inventory.
   d. Minus the beginning inventory.

23. In the calculation of the maximum limit for the annual provision for pension cost, the past service cost portion of the calculation should **not** be greater than
   a. Ten percent of the past service cost (until fully amortized).
   b. Ten percent of the actuarially computed value of the vested benefits.
   c. Seventy-five percent of the normal cost.
   d. An amount equivalent to amortization of the past service cost on a forty-year basis.

24. Pro forma effects of retroactive application would usually be reported on the face of the income statement for a change
   a. In the service lives of depreciable assets.
   b. In the salvage value of a depreciable asset.
   c. From the straight-line method of depreciation to the double-declining-balance method.
   d. From presenting statements for individual companies to presenting consolidated statements.

25. A company changes from the double-declining-balance method of depreciation for previously recorded assets to the straight-line method. The cumulative effect of the change on the amount of retained earnings at the beginning of the period in which the change is made, should be reported separately as a (an)
   a. Extraordinary item.
   b. Component of income after extraordinary items.
   c. Component of income from continuing operations.
   d. Prior period adjustment.

26. When computing information on a historical cost/constant dollar basis, which of the following is classified as nonmonetary?
   a. Obligations under warranties.
   b. Accrued expenses payable.
   c. Unamortized premium on bonds payable.
   d. Refundable deposits.

27. The amortization of bond discount on long-term debt should be presented in a statement of changes in financial position as a (an)
   a. Use of funds.
   b. Source and a use of funds.
   c. Addition to income.
   d. Deduction from income.

28. A loss on the sale of machinery in the ordinary course of business should be presented in a statement of changes in financial position as a (an)
   a. Deduction from income.
   b. Addition to income.
   c. Source and a use of funds.
   d. Use of funds.

29. Which of the following items, if material, should be presented in the income statement separately as a component of income, net of applicable income taxes?
   a. Write off of goodwill.
   b. Losses due to a strike.
   c. Losses from translation of foreign currencies.
   d. Gain from early extinguishment of long-term debt.

30. Which of the following is the appropriate basis for valuing fixed assets acquired in a business combination accounted for as a purchase carried out by exchanging cash for common stock?
   a. Historic cost.
   b. Book value.
   c. Cost plus any excess of purchase price over book value of asset acquired.
   d. Fair value.

31. When the allowance method of recognizing bad debt expense is used, the typical write off of a specific customer's account
    a. Has **no** effect on net income.
    b. Decreases net income.
    c. Decreases current assets.
    d. Decreases working capital.

32. A supportive argument for the pooling of interests method of accounting for a business combination is that
    a. One company is clearly the dominant and continuing entity.
    b. Goodwill is generally a part of any acquisition.
    c. It was developed within the boundaries of the historical-cost system and is compatible with it.
    d. A portion of the total cost is assigned to individual assets acquired on the basis of their fair value.

33. According to Statement of Financial Accounting Concepts No. 2, relevance and reliability are the two primary qualities that make accounting information useful for decision making. Predictive value is an ingredient of

	Relevance	*Reliability*
a.	No	No
b.	No	Yes
c.	Yes	Yes
d.	Yes	No

34. Which of the following utilizes the straight-line depreciation method?

	Composite depreciation	*Group depreciation*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

35. If the stock for a compensatory stock option plan is issued before some or all of the services are performed, a part of the consideration recorded for the stock issued is unearned compensation and should be shown in the balance sheet as a line item in
    a. Noncurrent liabilities.
    b. Stockholders' equity.
    c. Current assets.
    d. Noncurrent assets.

36. A method of accounting based on measures of historical prices in dollars, each of which has the same general purchasing power, is
    a. Current cost/constant dollar accounting.
    b. Current cost/nominal dollar accounting.
    c. Historical cost/constant dollar accounting.
    d. Historical cost/nominal dollar accounting.

37. Which of the following facts concerning plant assets should be disclosed in the Summary of Significant Accounting Policies?

	Composition	*Depreciation expense amount*
a.	No	Yes
b.	No	No
c.	Yes	No
d.	Yes	Yes

38. For interim financial reporting, an inventory loss from a market decline in the second quarter that is **not** expected to be restored in the fiscal year should be recognized as a loss
    a. In the fourth quarter.
    b. Proportionately in each of the second, third, and fourth quarters.
    c. Proportionately in each of the first, second, third, and fourth quarters.
    d. In the second quarter.

39. In accordance with FASB Statement No. 33, purchasing power gain or loss results from which of the following?

	Monetary assets and liabilities	*Nonmonetary assets and liabilities*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

40. A loss contingency for which the amount of loss can be reasonably estimated should be accrued when the occurrence of the loss is

	Reasonably possible	*Remote*
a.	Yes	No
b.	Yes	Yes
c.	No	No
d.	No	Yes

41. In job order costing, what journal entry should be made for the return to the storekeeper of direct materials previously issued to the factory for use on a particular job?
    a. Debit materials and credit factory overhead.
    b. Debit materials and credit work in process.
    c. Debit purchase returns and credit work in process.
    d. Debit work in process and credit materials.

42. The beginning work in process inventory was 60 percent complete as to conversion costs, and the ending work in process inventory was 45 percent complete as to conversion costs. The dollar amount of the conversion cost included in the ending work in process inventory (using the weighted-average method) is determined by multiplying the average unit conversion costs by what percentage of the total units in the ending work in process inventory?

a. 100 percent.
b. 60 percent.
c. 55 percent.
d. 45 percent.

43. When using full absorption costing, what costs attendant to an element of production (material, labor or overhead) are used in order to compute variances from standard amounts?

a. Controllable costs.
b. Total costs.
c. Variable costs.
d. Fixed costs.

44. For purposes of allocating joint costs to joint products, the relative sales value at split-off method could be used in which of the following situations?

	No costs beyond split-off	*Costs beyond split-off*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

45. An income statement is prepared as an internal report. Under which of the following methods would the term contribution margin appear?

	Absorption costing	*Direct costing*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

46. Which of the following capital budgeting techniques require(s) the use of cash flows from period to period?

	Internal rate of return	*Net present value*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

47. How may the following be used in calculating the breakeven point in units?

	Fixed costs	*Contribution margin per unit*
a.	Denominator	Numerator
b.	Denominator	Not used
c.	Numerator	Not used
d.	Numerator	Denominator

48. When using the graphic method of solving a linear-programming problem, which of the following would be depicted on the graph?

a. Coefficient of correlation.
b. Line of best fit.
c. Critical path.
d. Constraint.

49. How are the following used in the calculation of the net present value of a proposed project? Ignore income tax considerations.

	Depreciation expense	*Salvage value*
a.	Include	Include
b.	Include	Exclude
c.	Exclude	Include
d.	Exclude	Exclude

50. The contribution margin increases when sales volume remains the same and

a. Variable cost per unit decreases.
b. Variable cost per unit increases.
c. Fixed costs decrease.
d. Fixed costs increase.

51. Fixed assets utilized in a city-owned utility are accounted for in which of the following?

	Enterprise fund	*General fixed assets group of accounts*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

52. Which of the following funds of a governmental unit would use the general long-term debt account group to account for unmatured general long-term liabilities?

a. Special assessment.
b. Trust.
c. Internal service (intragovernmental service).
d. Debt service.

53. At the end of the fiscal year of a governmental unit, the excess of expenditures and encumbrances over appropriations
    a. Increases the fund balance.
    b. Decreases the fund balance.
    c. Increases the reserve for encumbrances.
    d. Decreases the reserve for encumbrances.

54. Which of the following accounts of a governmental unit is closed out at the end of the fiscal year?
    a. Fund balance.
    b. Reserve for encumbrances.
    c. Appropriations.
    d. Vouchers payable.

55. The encumbrance account of a governmental unit is debited when
    a. A purchase order is approved.
    b. Goods are received.
    c. A voucher payable is recorded.
    d. The budget is recorded.

56. Which of the following funds of a governmental unit recognizes revenues and expenditures under the same basis of accounting as the general fund?
    a. Debt service.
    b. Enterprise.
    c. Internal service (intragovernmental service).
    d. Nonexpendable pension trust.

57. Which of the following funds of a governmental unit would include retained earnings in its balance sheet?
    a. Expendable pension trust.
    b. Internal service (intragovernmental service).
    c. Special revenue.
    d. Capital projects.

58. Which of the following requires the use of the encumbrance system?
    a. Special assessment fund.
    b. Debt service fund.
    c. General fixed assets group of accounts.
    d. Enterprise fund.

59. Which of the following is utilized for current expenditures by a not-for-profit university?

	Unrestricted current funds	*Restricted current funds*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

60. Donated medicines which normally would be purchased by a hospital should be recorded at fair market value and should be credited directly to
    a. Other operating revenue.
    b. Other nonoperating revenue.
    c. Fund balance.
    d. Deferred revenue.

Number 2 (Estimated time —— 15 to 25 minutes)

Part a. At the end of its first year of operations, Key Company had a current marketable equity securities portfolio with a cost of $500,000 and a market value of $550,000. At the end of its second year of operations, Key Company had a current marketable equity securities portfolio with a cost of $525,000 and a market value of $475,000. No securities were sold during the first year. One security with a cost of $80,000 and a market value of $70,000 at the end of the first year was sold for $100,000 during the second year.

Required:
How should Key Company report the above facts in its balance sheets and income statements for both years? Discuss the rationale for your answer.

Part b. On July 1, 1981, Dynamic Company purchased for cash forty percent of the outstanding capital stock of Cart Company. Both Dynamic Company and Cart Company have a December 31 year end. Cart Company, whose common stock is actively traded in the over-the-counter market, reported its total net income for the year to Dynamic Company, and also paid cash dividends on November 15, 1981, to Dynamic Company and its other stockholders.

Required:
How should Dynamic Company report the above facts in its December 31, 1981, balance sheet and its income statement for the year then ended? Discuss the rationale for your answer.

Number 3 (Estimated time —— 15 to 25 minutes)

The Horizon Company is listed on the New York Stock Exchange. The market value of its common stock was quoted at $18 per share at both December 31, 1981, and December 31, 1980. Horizon's Balance Sheets at December 31, 1981, and December 31, 1980, and Statements of Income and Retained Earnings for the years then ended are presented below:

Horizon Company
BALANCE SHEETS

	December 31, 1981	December 31, 1980
	(000 omitted)	
Assets:		
Current assets:		
Cash	$ 3,500	$ 3,600
Marketable securities, at cost which approximates market	13,000	11,000
Accounts receivable, net of allowance for doubtful accounts	105,000	95,000
Inventories at lower of cost or market	126,000	154,000
Prepaid expenses	2,500	2,400
Total current assets	250,000	266,000
Property, plant and equipment, net of accumulated depreciation	311,000	308,000
Other assets	29,000	34,000
Total assets	$590,000	$608,000
Liabilities and Stockholders' Equity:		
Current liabilities:		
Notes payable	$ 5,000	$ 15,000
Accounts payable and accrued expenses	62,500	74,500
Income taxes payable	1,000	1,000
Payments due within one year on long-term debt	6,500	7,500
Total current liabilities	75,000	98,000
Long-term debt	169,000	180,000
Deferred income taxes	74,000	67,000
Other liabilities	9,000	8,000
Stockholders' equity:		
Common stock, par value $1.00 per share; authorized 20,000,000 shares; issued and outstanding 10,000,000 shares	10,000	10,000
Additional paid-in capital	111,000	111,000
Retained earnings	142,000	134,000
Total stockholders' equity	263,000	255,000
Total liabilities and stockholders' equity	$590,000	$608,000

Horizon Company
STATEMENTS OF INCOME AND RETAINED EARNINGS

	Year ended December 31,	
	1981	*1980*
	(000 omitted)	
Net sales	$600,000	$500,000
Costs and expenses:		
Cost of goods sold	480,000	400,000
Selling, general and administrative expenses	66,000	60,000
Other, net	17,000	6,000
Total costs and expenses	563,000	466,000
Income before income taxes	37,000	34,000
Income taxes	16,800	15,800
Net income	20,200	18,200
Retained earnings at beginning of period, as previously reported	141,000	132,000
Adjustment required for correction of an error	(7,000)	(6,000)
Retained earnings at beginning of period, as restated	134,000	126,000
Dividends on common stock	12,200	10,200
Retained earnings at end of period	$142,000	$134,000

Additional facts are as follows:

- "Selling, general and administrative expenses" for 1981 included a usual but infrequently occurring charge of $9,000,000.

- "Other, net" for 1981 included an extraordinary item (charge) of $10,000,000. If the extraordinary item (charge) had not occurred, income taxes for 1981 would have been $21,800,000 instead of $16,800,000.

- "Adjustment required for correction of an error" was a result of a change from an accounting principle that is not generally accepted to one that is generally accepted.

- Horizon Company has a simple capital structure and has disclosed earnings per common share for net income in the Notes to the Financial Statements.

Required:

a. Determine from the additional facts above whether or not the presentation of those facts in the above Horizon Company Statements of Income and Retained Earnings is appropriate. If the presentation is appropriate, discuss the theoretical rationale for the presentation. If the presentation is not appropriate, describe the appropriate presentation and discuss its theoretical rationale.

Do not discuss disclosure requirements for the Notes to the Financial Statements.

b. Describe the general significance of the following financial analysis tools:

- Quick (acid-test) ratio.
- Inventory turnover.
- Return on stockholders' equity.

c. Based on the Horizon Company Balance Sheets, Statements of Income and Retained Earnings, and additional facts, describe how to determine each of the above financial analysis tools (for the year 1981 only).

Number 4 (Estimated time —— 15 to 25 minutes)

Part a. This year Lorac Company has each of the following items in its income statement:

- Gross profits on installment sales.
- Revenues on long-term construction contracts.
- Estimated costs of product warranty contracts.
- Premiums on officers' life insurance with Lorac as beneficiary.

Required:

1. Under what conditions would deferred income taxes need to be reported in the financial statements?
2. Specify when deferred income taxes would need to be recognized for each of the items above, and indicate the rationale for such recognition.

Part b. Eneri Company's president has heard that deferred income taxes can be variously classified in the balance sheet.

Required:

Identify the conditions under which deferred income taxes would be classified as a noncurrent item in the balance sheet. What justification exists for such classification?

Number 5 (Estimated time —— 15 to 25 minutes)

Part a. Stein Company is going to use a predetermined annual factory overhead rate to charge factory overhead to products. In conjunction with this, Stein Company must decide whether to use direct labor hours or machine hours as the overhead rate base.

Required:

Discuss the objectives and criteria that Stein Company should use in selecting the base for its predetermined annual factory overhead rate.

Part b. Meyer Company's cost accounting department has prepared a factory overhead variance analysis report using the two-variance method. The plant manager of Meyer Company is interested in understanding the managerial usefulness of this report.

Required:

1. What are the purposes of a factory overhead variance analysis report?
2. Identify and explain the underlying assumptions associated with the two-variance method. Discuss the significance of each variance.

Uniform Certified Public Accountant Examination

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN ACCOUNTING PRACTICE — PART I

November 3, 1982; 1:30 to 6:00 P.M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	Estimated Minutes Minimum	Estimated Minutes Maximum
No. 1	45	55
No. 2	45	55
No. 3	45	55
No. 4	45	55
No. 5	40	50
Total	220	270

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers. Since objective items are computer-graded, your comments and calculations associated with them are not considered.

3. For problem-type questions you should enclose all scratch sheets. Failure to enclose scratch sheets may result in loss of grading points. Scratch sheets need not have page numbers, but you should show the question number and place them immediately following the question to which they relate.

4. Fourteen-column sheets, if any, should not be folded until all sheets, both wide and narrow, are placed in the proper sequence and fastened together at the top left corner. All fourteen-column sheets should then be wrapped around the back of the papers.

5. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of financial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

97. Gross billings for merchandise sold by Baker Company to its customers last year amounted to $5,260,000; sales returns and allowances reduced the amounts owed by $160,000. How much were net sales last year for Baker Company?

a. $4,800,000
b. $5,100,000
c. $5,200,000
d. $5,260,000

Answer Sheet

97. ⓐ ● ⓒ ⓓ

Items to be Answered

1. Star Company leased a new machine from Fox Company on December 31, 1981, under a lease with the following pertinent information:

Lease term	10 years
Annual rental payable at the beginning of each year	$200,000
Useful life of the machine	15 years
Implicit interest rate	10%
Present value of an annuity of $1 in advance for 10 periods at 10%	6.76
Present value of $1 for 10 periods at 10%	0.39

Star has the option to purchase the machine on December 31, 1991, by paying $250,000, which is significantly less than the $500,000 expected fair market value of the machine on the option exercise date. Assume that, at the inception of the lease, the exercise of the option appears to be reasonably assured. At the inception of the lease, Star should record a capitalized lease liability of

a. $1,254,500
b. $1,352,000
c. $1,449,500
d. $1,547,000

2. On January 1, 1976, Darby Company purchased, at par, 500 of the $1,000 face value, 8% bonds of Clark Corporation as a long-term investment. The bonds mature on January 1, 1986, and pay interest semi-annually on July 1 and January 1. Clark incurred heavy losses from operations for several years and defaulted on the July 1, 1980, and January 1, 1981, interest payments. Because of the permanent decline in market value of Clark's bonds, Darby wrote down its investment to $400,000 at December 31, 1980. Pursuant to Clark's plan of reorganization effected on July 1, 1981, Darby received 5,000 shares of $100 par value, 8% cumulative preferred stock of Clark in exchange for the $500,000 face value bond investment. The quoted market value of the preferred stock was $70 per share on July 1, 1981. What amount of loss should be included in the determination of Darby's net income for 1981?

a. $0
b. $ 50,000
c. $100,000
d. $150,000

3. Alden Corporation provides an allowance for its doubtful accounts receivable. At December 31, 1980, the allowance account had a credit balance of $8,000. Each month Alden accrues bad debt expense in an amount equal to 2% of credit sales. Total credit sales during 1981 amounted to $2,000,000. During 1981 uncollectible accounts receivable totaling $22,000 were written off against the allowance account. An aging of accounts receivable at December 31, 1981, indicates that an allowance of $42,000 should be provided for doubtful accounts as of that date. Accordingly, bad debt expense previously accrued during 1981 should be increased by

a. $62,000
b. $42,000
c. $26,000
d. $16,000

4. During 1980 Bradley Corporation issued for $110 per share, 5,000 shares of $100 par value convertible preferred stock. One share of preferred stock can be converted into three shares of Bradley's $25 par value common stock at the option of the preferred shareholder. On December 31, 1981, all of the preferred stock was converted into common stock. The market value of the common stock at the conversion date was $40 per share. What amount should be credited to the common stock account on December 31, 1981?

a. $375,000
b. $500,000
c. $550,000
d. $600,000

5. Wright Company sells for cash major household appliance service contracts agreeing to service customers' appliances for a one-year, two-year, or three-year period. Cash receipts from contracts are credited to unearned service contract revenues and this account had a balance of $1,440,000 at December 31, 1981, before year-end adjustment. Service contract costs are charged to service contract expense as incurred and this account had a balance of $360,000 at December 31, 1981. Outstanding service contracts at December 31, 1981, expire as follows:

During 1982 —	$300,000
During 1983 —	450,000
During 1984 —	200,000

What amount should Wright report as unearned service contract revenues at December 31, 1981?
  a. $ 490,000
  b. $ 712,500
  c. $ 950,000
  d. $1,080,000

6. Tallent Company received a $30,000, 6-month, 10% interest-bearing note from a customer. After holding the note for two months, Tallent was in need of cash and discounted the note at the United National Bank at a 12% discount rate. The amount of cash received by Tallent from the bank was
  a. $31,260
  b. $30,870
  c. $30,300
  d. $30,240

7. In an effort to increase sales, Mills Company inaugurated a sales promotional campaign on June 30, 1981. Mills placed a coupon redeemable for a premium in each package of cereal sold. Each premium costs Mills $1 and five coupons must be presented by a customer to receive a premium. Mills estimated that only 60% of the coupons issued will be redeemed. For the six months ended December 31, 1981, the following information is available:

Packages of cereal sold	*Premiums purchased*	*Coupons redeemed*
1,600,000	120,000	400,000

What is the estimated liability for premium claims outstanding at December 31, 1981?
  a. $ 80,000
  b. $112,000
  c. $144,000
  d. $192,000

8. Harris, Inc., leased equipment under a capital lease for a period of seven years, contracting to pay $100,000 rent in advance at the start of the lease term on December 31, 1980, and $100,000 annually on December 31 of each of the next six years. The present value at December 31, 1980, of the seven rent payments over the lease term discounted at 10% (the implicit interest rate) was $535,000. Harris amortizes its liability under capital lease using the effective interest method. In its December 31, 1981, balance sheet, Harris should report a liability under capital lease of
  a. $378,500
  b. $391,500
  c. $437,350
  d. $500,000

9. On September 30, 1982, Grey Company issued 3,000 shares of its $10 par common stock in connection with a stock dividend. No entry was made on the stock dividend declaration date. The market value per share immediately after isssuance was $15. Grey's stockholders' equity accounts immediately before issuance of the stock dividend shares were as follows:

Common stock, $10 par; 50,000 shares authorized; 20,000 shares outstanding	$200,000
Additional paid-in capital	300,000
Retained earnings	350,000

What should be the retained earnings balance immediately after the stock dividend?
  a. $305,000
  b. $320,000
  c. $327,500
  d. $350,000

10. The stockholders' equity account balances of Rice Corporation as of December 31, 1981, are as follows:

Common stock, $10 par; 50,000 shares authorized; 25,000 shares issued	$250,000
Paid-in capital in excess of par	50,000
Retained earnings	100,000
Less treasury stock, 2,000 shares at cost	(32,000)
Total stockholders' equity	$368,000

On January 4, 1982, Rice sold the treasury shares on the open market at $20 per share. The entry to record this sale on Rice's books should include a credit to
  a. Gain from sale of treasury stock of $8,000.
  b. Paid-in capital from treasury stock of $8,000.
  c. Retained earnings of $8,000.
  d. Paid-in capital from treasury stock of $12,000.

Items 11 and 12 are based on the following information:

The following condensed balance sheet is presented for the partnership of Cooke, Dorry, and Evans who share profits and losses in the ratio of 4:3:3, respectively:

Cash	$ 90,000
Other assets	820,000
Cooke, loan	30,000
	$940,000
Accounts payable	$210,000
Evans, loan	40,000
Cooke, capital	300,000
Dorry, capital	200,000
Evans, capital	190,000
	$940,000

11. Assume that the assets and liabilities are fairly valued on the balance sheet and the partnership decides to admit Fisher as a new partner with a one-fourth interest. No goodwill or bonus is to be recorded. How much should Fisher contribute in cash or other assets?
    a. $172,500
    b. $175,000
    c. $230,000
    d. $233,333

12. Assume that instead of admitting a new partner, the partners decide to liquidate the partnership. If the other assets are sold for $600,000, how much of the available cash should be distributed to Cooke?
    a. $170,000
    b. $182,000
    c. $212,000
    d. $300,000

13. White Airlines sold a used jet aircraft to Brown Company for $800,000, accepting a five-year 6% note for the entire amount. Brown's incremental borrowing rate was 14%. The annual payment of principal and interest on the note was to be $189,930. The aircraft could have been sold at an established cash price of $651,460. The present value of an ordinary annuity of $1 at 8% for five periods is 3.99. The aircraft should be capitalized on Brown's books at
    a. $651,460
    b. $757,820
    c. $800,000
    d. $949,650

14. On April 1, 1980, Pine Construction Company entered into a fixed-price contract to construct an apartment building for $6,000,000. Pine appropriately accounts for this contract under the percentage-of-completion method. Information relating to the contract is as follows:

	At December 31, 1980	*At December 31, 1981*
Percentage of completion	20%	60%
Estimated costs at completion	$4,500,000	$4,800,000
Income recognized (cumulative)	$ 300,000	$ 720,000

What is the amount of contract costs incurred during the year ended December 31, 1981?
    a. $1,200,000
    b. $1,920,000
    c. $1,980,000
    d. $2,880,000

15. Effective January 1, 1981, Younger Company adopted the accounting principle of expensing as incurred advertising and promotion costs. Previously, advertising and promotion costs applicable to future periods were recorded in prepaid expenses. Younger can justify the change, which was made for both financial statement and income tax reporting purposes. Younger's prepaid advertising and promotion costs totaled $500,000 at December 31, 1980. Assume that the income tax rate is 40% for 1980 and 1981. The adjustment for the effect of this change in accounting principle should result in a net charge against income in the 1981 income statement of
    a. $0
    b. $200,000
    c. $300,000
    d. $500,000

16. Wells Company purchased a machine on January 1, 1978, for $480,000. At the date of acquisition the machine had an estimated useful life of six years with no salvage value. The machine is being depreciated on the straight-line basis. On January 1, 1981, Wells determined, as a result of additional information, that the machine had an estimated useful life of eight years from the date of acquisition with no salvage value. An accounting change was made in 1981 to reflect this additional information. What is the amount of depreciation expense on this machine for the year ended December 31, 1981?
    a. $0
    b. $30,000
    c. $48,000
    d. $60,000

17. On January 1, 1981, Stoner Corporation granted stock options to key employees for the purchase of 10,000 shares of the company's common stock at $25 per share. The options are intended to compensate employees for the next two years. The options are exercisable within a four-year period beginning January 1, 1983, by grantees still in the employ of the company. The market price of Stoner's common stock was $32 per share at the date of grant. Stoner plans to distribute up to 10,000 shares of treasury stock when options are exercised. The treasury stock was acquired by Stoner during 1980 at a cost of $28 per share and was recorded under the cost method. Assume that no stock options were terminated during the year. How much should Stoner charge to compensation expense for the year ended December 31, 1981?
   a. $70,000
   b. $35,000
   c. $30,000
   d. $15,000

18. On December 31, 1979, Marsh Company entered into a debt restructuring agreement with Saxe Company, which was experiencing financial difficulties. Marsh restructured a $100,000 note receivable as follows:

- Reduced the principal obligation to $70,000.
- Forgave $12,000 of accrued interest.
- Extended the maturity date from December 31, 1979, to December 31, 1981.
- Reduced the interest rate from 12% to 8%. Interest was payable annually on December 31. 1980, and 1981.

In accordance with the agreement, Saxe made payments to Marsh on December 31, 1980 and 1981. How much interest income should Marsh report for the year ended December 31, 1981?
   a. $0
   b. $ 5,600
   c. $ 8,400
   d. $11,200

19. A truck owned and operated by Ward Company was involved in an accident with an auto driven by Stillman on January 12, 1981. Ward received notice on April 24, 1981, of a lawsuit for $800,000 damages for a personal injury suffered by Stillman. Ward's counsel believes it is reasonably possible that Stillman will be successful against the company for an estimated amount in the range between $100,000 and $400,000. No amount within this range is a better estimate of potential damages than any other amount. It is expected that the lawsuit will be adjudicated in the latter part of 1982. What amount of loss should Ward accrue at December 31, 1981?
   a. $0
   b. $100,000
   c. $250,000
   d. $400,000

20. Hines Corporation reports operating profit as to industry segments in its supplementary financial information annually. The following information is available for 1981:

	Sales	*Traceable costs*
Segment A	$ 750,000	$450,000
Segment B	500,000	225,000
Segment C	250,000	125,000
	$1,500,000	$800,000

Additional expenses not included above are as follows:

Indirect operating expenses	$240,000
General corporate expenses	180,000
Interest expense	96,000

Hines allocates common costs based on the ratio of a segment's sales to total sales. What should be the operating profit for segment B for 1981?
   a. $103,000
   b. $135,000
   c. $163,000
   d. $195,000

Number 2 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of managerial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

21. Dean Company is preparing a flexible budget for 1982 and the following maximum capacity estimates for department M are available:

	At maximum capacity
Direct-labor hours	60,000
Variable factory overhead	$150,000
Fixed factory overhead	$240,000

Assume that Dean's normal capacity is 80% of maximum capacity. What would be the total factory overhead rate, based on direct-labor hours, in a flexible budget at normal capacity?
   a. $6.00
   b. $6.50
   c. $7.50
   d. $8.13

Items 22 and 23 are based on the following information:

Hamilton Company uses job order costing. Factory overhead is applied to production at a predetermined rate of 150% of direct-labor cost. Any over or underapplied factory overhead is closed to the cost of goods sold account at the end of each month. Additional information is available as follows:

- Job 101 was the only job in process at January 31, 1982, with accumulated costs as follows:

Direct materials	$4,000
Direct labor	2,000
Applied factory overhead	3,000
	$9,000

- Jobs 102, 103, and 104 were started during February.
- Direct materials requisitions for February totaled $26,000.
- Direct-labor cost of $20,000 was incurred for February.
- Actual factory overhead was $32,000 for February.
- The only job still in process at February 28, 1982, was Job 104, with costs of $2,800 for direct materials and $1,800 for direct labor.

22. The cost of goods manufactured for February 1982 was
 a. $77,700
 b. $78,000
 c. $79,700
 d. $85,000

23. Over or underapplied factory overhead should be closed to the cost of goods sold account at February 28, 1982, in the amount of
 a. $ 700 overapplied.
 b. $1,000 overapplied.
 c. $1,700 underapplied.
 d. $2,000 underapplied.

Items 24 and 25 are based on the following information:

Selected information concerning the operations of Kern Company for the year ended December 31, 1981, is available as follows:

Units produced	10,000
Units sold	9,000
Direct materials used	$40,000
Direct labor incurred	$20,000
Fixed factory overhead	$25,000
Variable factory overhead	$12,000
Fixed selling and administrative expenses	$30,000
Variable selling and administrative expenses	$ 4,500
Finished goods inventory, January 1, 1981	None

There were no work-in-process inventories at the beginning and end of 1981.

24. What would be Kern's finished goods inventory cost at December 31, 1981, under the variable (direct) costing method?
 a. $7,200
 b. $7,650
 c. $8,000
 d. $9,700

25. Which costing method, absorption or variable costing, would show a higher operating income for 1981 and by what amount?

	Costing method	*Amount*
a.	Absorption costing	$2,500
b.	Variable costing	$2,500
c.	Absorption costing	$5,500
d.	Variable costing	$5,500

26. Heller Company purchased a machine for $500,000 with a useful life of five years and no salvage value. The machine is being depreciated using the straight-line method and it is expected to produce annual cash flow from operations, net of income taxes, of $150,000. The present value of an ordinary annuity of $1 for five periods at 14% is 3.43. The present value of $1 for five periods at 14% is 0.52. Assuming that Heller uses a time-adjusted rate of return of 14%, what is the net present value?
 a. $280,000
 b. $250,000
 c. $180,000
 d. $ 14,500

27. Reid Company is budgeting sales of 100,000 units of product R for the month of September 1982. Production of one unit of product R requires two units of material A and three units of material B. Actual inventory units at September 1 and budgeted inventory units at September 30 are as follows:

	Actual inventory at September 1	*Budgeted inventory at September 30*
Product R	20,000	10,000
Material A	25,000	18,000
Material B	22,000	24,000

How many units of material B is Reid planning to purchase during September 1982?
   a. 328,000
   b. 302,000
   c. 298,000
   d. 272,000

Items 28 and 29 are based on the following information:

Harper Company's Job 501 for the manufacture of 2,200 coats was completed during August 1982 at the following unit costs:

Direct materials	$20
Direct labor	18
Factory overhead (includes an allowance of $1 for spoiled work)	18
	$56

Final inspection of Job 501 disclosed 200 spoiled coats which were sold to a jobber for $6,000.

28. Assume that spoilage loss is charged to all production during August 1982. What would be the unit cost of the good coats produced on Job 501?
   a. $53.00
   b. $55.00
   c. $56.00
   d. $58.60

29. Assume, instead, that the spoilage loss is attributable to exacting specifications of Job 501 and is charged to this specific job. What would be the unit cost of the good coats produced on Job 501?
   a. $55.00
   b. $57.50
   c. $58.60
   d. $61.60

---

30. Eriksen Company has budgeted its activity for October 1982 based on the following information:

- Sales are budgeted at $300,000. All sales are credit sales and a provision for doubtful accounts is made monthly at the rate of 3% of sales.
- Merchandise inventory was $70,000 at September 30, 1982, and an increase of $10,000 is planned for the month.
- All merchandise is marked up to sell at invoice cost plus 50%.
- Estimated cash disbursements for selling and administrative expenses for the month are $40,000.
- Depreciation for the month is projected at $5,000.

Eriksen is projecting operating income for October 1982 in the amount of
   a. $96,000
   b. $56,000
   c. $55,000
   d. $46,000

31. During March 1982 Adams Company had sales of $5,000,000, variable costs of $3,000,000 and fixed costs of $1,500,000 for product M. Assume that cost behavior and unit selling price remain unchanged during April. In order for Adams to realize operating income of $300,000 from product M for April, sales would have to be
   a. $3,750,000
   b. $4,050,000
   c. $4,500,000
   d. $4,800,000

Items 32 and 33 are based on the following information:

Bronson Company had 6,000 units in work-in-process at January 1, 1982, which were 60% complete as to conversion costs. During January 20,000 units were completed. At January 31, 1982, 8,000 units remained in work-in-process which were 40% complete as to conversion costs. Materials are added at the beginning of the process.

32. Using the weighted-average method, the equivalent units for January for conversion costs were
   a. 19,600
   b. 22,400
   c. 23,200
   d. 25,600

33. How many units were started during January?
   a. 18,000
   b. 19,600
   c. 20,000
   d. 22,000

---

34. Brooks Company uses the following flexible budget formula for the 1982 annual maintenance cost in department T:

Total cost = $7,200 + $0.60 per machine hour

The July 1982 operating budget is based upon 20,000 hours of planned machine time. Maintenance cost included in this flexible budget is
   a. $11,400
   b. $12,000
   c. $12,600
   d. $19,200

35. Jordan Company budgeted sales of 400,000 calculators at $40 per unit for 1982. Variable manufacturing costs were budgeted at $16 per unit, and fixed manufacturing costs at $10 per unit. A special order offering to buy 40,000 calculators for $23 each was received by Jordan in March 1982. Jordan has sufficient plant capacity to manufacture the additional quantity; however, the production would have to be done on an overtime basis at an estimated additional cost of $3 per calculator. Acceptance of the special order would not affect Jordan's normal sales and no selling expenses would be incurred. What would be the effect on operating profit if the special order were accepted?
   a. $120,000 decrease.
   b. $160,000 increase.
   c. $240,000 decrease.
   d. $280,000 increase.

Items 36 and 37 are based on the following information:

Hanley Company purchased a machine for $125,000 which will be depreciated on the straight-line basis over a five-year period with no salvage value. The related cash flow from operations, net of income taxes, is expected to be $45,000 a year. Assume that Hanley's effective income tax rate is 40% for all years.

36. What is the payback period?
   a. 2.1 years.
   b. 2.3 years.
   c. 2.8 years.
   d. 4.2 years.

37. What is the accounting (book value) rate of return on the initial increase in required investment?
   a. 16%
   b. 24%
   c. 28%
   d. 36%

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38. In preparing its budget for July 1982, Robinson Company has the following accounts receivable information available:

Accounts receivable at June 30, 1982	$350,000
Estimated credit sales for July	400,000
Estimated collections in July for credit sales in July and prior months	320,000
Estimated write-offs in July for uncollectible credit sales	16,000
Estimated provision for doubtful accounts for credit sales in July	12,000

What is the projected balance of accounts receivable at July 31, 1982?
   a. $402,000
   b. $414,000
   c. $426,000
   d. $430,000

39. Wilson Company prepared the following preliminary forecast concerning product G for 1982 assuming no expenditure for advertising:

Selling price per unit	$10
Unit sales	100,000
Variable costs	$600,000
Fixed costs	$300,000

Based on a market study in December 1981, Wilson estimated that it could increase the unit selling price by 15% and increase the unit sales volume by 10% if $100,000 were spent on advertising. Assuming that Wilson incorporates these changes in its 1982 forecast, what should be the operating income from product G?
   a. $175,000
   b. $190,000
   c. $205,000
   d. $365,000

40. Kipling Company invested in an eight-year project. It is expected that the annual cash flow from the project, net of income taxes, will be $20,000. Information on present value factors is as follows:

Present value of $1 at 12% for eight periods	0.404
Present value of an ordinary annuity of $1 at 12% for eight periods	4.968

Assuming that Kipling based its investment decision on an internal rate of return of 12%, how much did the project cost?
   a. $160,000
   b. $ 99,360
   c. $ 80,800
   d. $ 64,640

Number 3 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **the federal taxation of individuals.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. The answers should be based upon 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. Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

41. Robert Efron owned an apartment house that he bought in 1970. Depreciation was taken on a straight-line basis. In 1982, when Efron's adjusted basis for this property was $100,000, he traded it for an office building having a fair market value of $300,000. The apartment house has 100 dwelling units, while the office building has 50 units rented to business enterprises. The properties are not located in the same city. What is Efron's reportable gain on this exchange?
   a. $0.
   b. $200,000 long-term capital gain.
   c. $200,000 Section 1231 gain.
   d. $200,000 Section 1250 gain.

42. In 1980, Jack Bard loaned $1,500 to his cousin, Milton, for a wedding ring. Milton gave Jack a 10% interest-bearing note for $1,500, maturing in 1982. Milton made timely interest payments on the note, but declared bankruptcy in 1982 and defaulted on the principal. What loss can Jack claim on his 1982 tax return?
   a. $0.
   b. $1,400 casualty loss.
   c. $1,500 short-term capital loss.
   d. $1,500 long-term capital loss.

43. Alex Berger, a retired building contractor, earned the following income during 1981:

Director's fee received from Keith Realty Corp.	$ 600
Executor's fee received from the estate of his deceased sister	7,000

Berger's self-employment income for 1981 is
   a. $0
   b. $ 600
   c. $7,000
   d. $7,600

44. Daniel Kelly received interest income from the following sources in 1981:

New York Port Authority bonds	$1,000
Puerto Rico Commonwealth bonds	1,800

What portion of such interest is tax exempt?
   a. $0
   b. $1,000
   c. $1,800
   d. $2,800

45. Martin Dawson, who resided in Detroit, was unemployed for the last six months of 1981. In January 1982, he moved to Houston to seek employment, and obtained a full-time job there in February. He kept this job for the balance of the year. Martin paid the following expenses in 1982 in connection with his move:

Rental of truck to move his personal belongings to Houston	$ 800
Penalty for breaking the lease on his Detroit apartment	300
Total	$1,100

How much can Martin deduct in 1982 for moving expenses?
   a. $0
   b. $ 300
   c. $ 800
   d. $1,100

46. Mr. and Mrs. Alvin Charak took a foster child, Robert, into their home in 1981. A state welfare agency paid the Charaks $3,900 during the year for related expenses. Actual expenses incurred by the Charaks during 1981 in caring for Robert amounted to $3,000. The remaining $900 was spent by the Charaks in 1981 towards their own personal expenses. How much of the foster child payments is taxable income to the Charaks in 1981?
   a. $0
   b. $ 900
   c. $2,900
   d. $3,900

47. David Hetnar is covered by a $90,000 group-term life insurance policy of which his wife is the beneficiary. Hetnar's employer pays the entire cost of the policy, for which the uniform annual premium is $8 per $1,000 of coverage. How much of this premium is taxable to Hetnar?
   a. $0
   b. $320
   c. $360
   d. $720

48. Lila Lux retired on December 31, 1980, with a monthly pension of $300. Her contributions to the pension plan totaled $6,000, while her employer's contributions to the plan totaled $12,000. How much of the pension is taxable in 1981?

a. $0
b. $1,800
c. $2,400
d. $3,600

49. Paul Benson and Arthur Kronk each own one-half of the stock of Bekro Corporation, which has earnings and profits of $15,000. Bekro distributes property with a basis of $9,000 and a fair market value of $24,000 to its stockholders, each stockholder receiving property with a basis of $4,500 and a fair market value of $12,000. The gross amount reportable by each stockholder as a dividend is

a. $0
b. $ 4,500
c. $ 7,500
d. $12,000

50. Edward Ryan, who is single, had adjusted gross income, other than unemployment compensation, of $25,000 in 1981. Ryan had no disability income exclusion, but received $3,000 in unemployment compensation benefits during the year. How much of the unemployment compensation is taxable in 1981?

a. $0
b. $1,500
c. $2,500
d. $3,000

51. Sara Harding is a cash basis taxpayer who itemizes her deductions. The following information pertains to Sara's state income taxes for the taxable year 1981:

Withheld by employer in 1981		$2,000
Payments on 1981 estimate:		
4/15/81	$300	
6/15/81	300	
9/15/81	300	
1/15/82	300	1,200
Total paid and withheld		$3,200
Actual tax, per state return		3,000
Overpayment		$ 200

There was no balance of tax or refund due on Sara's 1980 state tax return. How much is deductible for state income taxes on Sara's 1981 federal income tax return?

a. $2,800
b. $2,900
c. $3,000
d. $3,200

52. On December 15, 1981, Donald Calder made a contribution of $500 to a qualified charitable organization, by charging the contribution on his bank credit card. Calder paid the $500 on January 20, 1982, upon receipt of the bill from the bank. In addition, Calder issued and delivered a promissory note for $1,000 to another qualified charitable organization on November 1, 1981, which he paid upon maturity six months later. If Calder itemizes his deductions, what portion of these contributions is deductible in 1981?

a. $0
b. $ 500
c. $1,000
d. $1,500

53. One of the requirements for claiming the earned income credit is that the individual's

a. Earned income must be $10,000 or more.
b. Earned income must be $10,000 or less.
c. Adjusted gross income must be less than $10,000.
d. Adjusted gross income must be equal to earned income.

Items 54 through 56 are based on the following data:

In 1978, John Cote bought 100 shares of a listed stock for $2,400. In 1980, when the fair market value was $2,200, John gave the stock to his brother, David. No gift tax was due.

54. If David sells this stock in 1982 for $2,600, his basis is

a. $0
b. $2,200
c. $2,400
d. $2,600

55. If David sells this stock in 1982 for $2,000, his basis is

a. $0
b. $2,000
c. $2,200
d. $2,400

56. If David sells this stock in 1982 for $2,300, his reportable gain or loss is

a. $0.
b. $100 loss.
c. $100 gain.
d. $2,300 gain.

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57. Nora Hayes, a widow, maintains a home for herself and her two dependent preschool children. In 1982, Nora's earned income and adjusted gross income was $29,000. During 1982, Nora paid work-related expenses of $3,000 for a housekeeper to care for her children. How much can Nora claim for child care credit in 1982?
    a. $0
    b. $480
    c. $600
    d. $900

58. Ronald Birch, who is single, earned a salary of $30,000 in 1982 as a plumber employed by Lupo Company. Birch was covered for the entire year 1982 under Lupo's qualified pension plan for employees. In addition, Birch had a net income of $10,000 from self-employment in 1982. What is the maximum amount that Birch can deduct in 1982 for contributions to an individual retirement account (IRA)?
    a. $4,500
    b. $2,000
    c. $1,500
    d. $0

59. On January 10, 1970, Martin Mayne bought 3,000 shares of Hance Corporation stock for $300,000. The fair market values of this stock on the following dates were as follows:

Dec. 31, 1980	$210,000
Mar. 31, 1981	240,000
June 30, 1981	270,000

Martin died on December 31, 1980, bequeathing this stock to his son, Philip. The stock was distributed to Philip on March 31, 1981. The alternate valuation date was elected for Martin's estate. Philip's basis for this stock is
    a. $210,000
    b. $240,000
    c. $270,000
    d. $300,000

60. Fred Wright filed his 1981 income tax return on March 15, 1982, showing gross income of $20,000. He had mistakenly omitted $6,000 of income which, in good faith, he considered nontaxable. By what date must the Internal Revenue Service assert a notice of deficiency?
    a. March 15, 1985.
    b. April 15, 1985.
    c. March 15, 1988.
    d. April 15, 1988.

Number 4 (Estimated time —— 45 to 55 minutes)

Presented below are the balance sheets of Farrell Corporation as of December 31, 1981 and 1980, and the statement of income and retained earnings for the year ended December 31, 1981.

Farrell Corporation
BALANCE SHEETS
December 31, 1981 and 1980

	1981	*1980*	*Increase (Decrease)*
Assets			
Cash	$ 275,000	$ 180,000	$ 95,000
Accounts receivable, net	295,000	305,000	(10,000)
Inventories	549,000	431,000	118,000
Investment in Hall, Inc., at equity	73,000	60,000	13,000
Land	350,000	200,000	150,000
Plant and equipment	624,000	606,000	18,000
Less accumulated depreciation	(139,000)	(107,000)	(32,000)
Goodwill	16,000	20,000	(4,000)
Total assets	$2,043,000	$1,695,000	$348,000
Liabilities and Stockholders' Equity			
Accounts payable and accrued expenses	$ 604,000	$ 563,000	$ 41,000
Note payable, long-term	150,000	—	150,000
Bonds payable	160,000	210,000	(50,000)
Deferred income taxes	41,000	30,000	11,000
Common stock, par value $10	430,000	400,000	30,000
Additional paid-in capital	226,000	175,000	51,000
Retained earnings	432,000	334,000	98,000
Treasury stock, at cost	—	(17,000)	17,000
Total liabilities and stockholders' equity	$2,043,000	$1,695,000	$348,000

Farrell Corporation
STATEMENT OF INCOME AND RETAINED EARNINGS
For the Year Ended December 31, 1981

Net sales	$1,950,000
Operating expenses:	
Cost of sales	1,150,000
Selling and administrative expenses	505,000
Depreciation	53,000
	1,708,000
Operating income	242,000
Other (income) expense:	
Interest expense	15,000
Equity in net income of Hall, Inc.	(13,000)
Loss on sale of equipment	5,000
Amortization of goodwill	4,000
	11,000
Income before income taxes	231,000
Income taxes:	
Current	79,000
Deferred	11,000
Provision for income taxes	90,000
Net income	141,000
Retained earnings, January 1, 1981	334,000
	475,000
Cash dividends, paid August 14, 1981	43,000
Retained earnings, December 31, 1981	$ 432,000

Additional information:

- On January 2, 1981, Farrell sold equipment costing $45,000, with a book value of $24,000, for $19,000 cash.
- On April 1, 1981, Farrell issued 1,000 shares of common stock for $23,000 cash.
- On May 15, 1981, Farrell sold all of its treasury stock for $25,000 cash.
- On June 1, 1981, individuals holding $50,000 face value of Farrell's bonds exercised their conversion privilege. Each of the 50 bonds was converted into 40 shares of Farrell's common stock.
- On July 1, 1981, Farrell purchased equipment for $63,000 cash.
- On December 31, 1981, land with a fair market value of $150,000 was purchased through the issuance of a long-term note in the amount of $150,000. The note bears interest at the rate of 15% and is due on December 31, 1986.
- Deferred income taxes represent timing differences relating to the use of accelerated depreciation methods for income tax reporting and the straight-line method for financial statement reporting.

Required:
Using the cash basis approach (funds defined as cash), prepare a statement of changes in financial position of Farrell Corporation for the year ended December 31, 1981.

Number 5 (Estimated time —— 40 to 50 minutes)

Number 5 consists of two unrelated parts.

Part a. Information concerning Tully Corporation's intangible assets is as follows:

- On January 1, 1981, Tully signed an agreement to operate as a franchisee of Rapid Copy Service, Inc., for an initial franchise fee of $85,000. Of this amount, $25,000 was paid when the agreement was signed and the balance is payable in four annual payments of $15,000 each beginning January 1, 1982. The agreement provides that the down payment is not refundable and no future services are required of the franchisor. The present value at January 1, 1981, of the four annual payments discounted at 14% (the implicit rate for a loan of this type) is $43,700. The agreement also provides that 5% of the revenue from the franchise must be paid to the franchisor annually. Tully's revenue from the franchise for 1981 was $900,000. Tully estimates the useful life of the franchise to be ten years.

- Tully incurred $78,000 of experimental and development costs in its laboratory to develop a patent which was granted on January 2, 1981. Legal fees and other costs associated with registration of the patent totaled $16,400. Tully estimates that the useful life of the patent will be eight years.

- A trademark was purchased from Walton Company for $40,000 on July 1, 1978. Expenditures for successful litigation in defense of the trademark totaling $10,000 were paid on July 1, 1981. Tully estimates that the useful life of the trademark will be 20 years from the date of acquisition.

Required:

1. Prepare a schedule showing the intangibles section of Tully's balance sheet at December 31, 1981. Show supporting computations in good form.

2. Prepare a schedule showing all expenses resulting from the transactions that would appear on Tully's income statement for the year ended December 31, 1981. Show supporting computations in good form.

Part b. On January 1, 1980, Brock Corporation purchased a tract of land (site number 101) with a building for $600,000. Additionally, Brock paid a real estate broker's commission of $36,000, legal fees of $6,000, and title guarantee insurance of $18,000. The closing statement indicated that the land value was $500,000 and the building value was $100,000. Shortly after acquisition, the building was razed at a cost of $75,000.

Brock entered into a $3,000,000 fixed-price contract with Barnett Builders, Inc., on March 1, 1980, for the construction of an office building on land site number 101. The building was completed and occupied on September 30, 1981. Additional construction costs were incurred as follows:

Plans, specifications and blueprints	$12,000
Architects' fees for design and supervision	95,000

The building is estimated to have a forty-year life from date of completion and will be depreciated using the 150% declining balance method.

To finance the construction cost, Brock borrowed $3,000,000 on March 1, 1980. The loan is payable in ten annual installments of $300,000 plus interest at the rate of 14%. Brock's average amounts of accumulated building construction expenditures were as follows:

For the period March 1 to December 31, 1980	$ 900,000
For the period January 1 to September 30, 1981	2,300,000

Required:

1. Prepare a schedule which discloses the individual costs making up the balance in the land account in respect of land site number 101 as of September 30, 1981.

2. Prepare a schedule which discloses the individual costs that should be capitalized in the office building account as of September 30, 1981. Show supporting computations in good form.

3. Prepare a schedule showing the depreciation expense computation of the office building for the year ended December 31, 1981.

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN ACCOUNTING PRACTICE — PART II

November 4, 1982; 1:30 to 6:00 P.M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	45	55
No. 2	45	55
No. 3	45	55
No. 4	45	55
No. 5	40	50
Total	220	270

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers. Since objective items are computer-graded, your comments and calculations associated with them are not considered.

3. For problem-type questions you should enclose all scratch sheets. Failure to enclose scratch sheets may result in loss of grading points. Scratch sheets need not have page numbers, but you should show the question number and place them immediately following the question to which they relate.

4. Fourteen-column sheets, if any, should not be folded until all sheets, both wide and narrow, are placed in the proper sequence and fastened together at the top left corner. All fourteen-column sheets should then be wrapped around the back of the papers.

5. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of financial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

97. Gross billings for merchandise sold by Baker Company to its customers last year amounted to $5,260,000; sales returns and allowances reduced the amounts owed by $160,000. How much were net sales last year for Baker Company?

a. $4,800,000
b. $5,100,000
c. $5,200,000
d. $5,260,000

Answer Sheet

97. (a) ● (c) (d)

Items to be Answered

1. Anton Corporation's retained earnings at December 31, 1981, amounted to $1,000,000. On that date Anton declared a property dividend. The property to be distributed had a carrying value of $100,000 and a fair market value of $180,000 at the declaration date. How much gain should Anton recognize as a result of this distribution?

a. $0
b. $ 80,000
c. $100,000
d. $180,000

2. The following expenditures were among those incurred by Jensen Corporation during the year ended December 31, 1981:

• Replacement of tiles on portion of roof that had been leaking	$4,000
• Overhaul of machinery that is expected to extend its useful life for another two years	6,000

How much should be charged to repairs and maintenance in 1981?

a. $0
b. $ 4,000
c. $ 6,000
d. $10,000

Items 3 and 4 are based on the following data:

On March 1, 1982, Agront Corporation issued 10,000 shares of its $1 par value common stock for all of the outstanding stock of Barcelo Corporation, when the fair market value of Agront's stock was $50 per share. In addition, Agront made the following payments in connection with this business combination:

Finder's and consultants' fees	$20,000
SEC registration costs	7,000

3. If this business combination is treated as a pooling of interests, how much should be recorded as business combination expenses in 1982?

a. $0
b. $ 7,000
c. $20,000
d. $27,000

4. If this business combination is treated as a purchase, Agront's acquisition cost would be capitalized at

a. $0
b. $500,000
c. $520,000
d. $527,000

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5. Ventura Corporation was organized on January 1, 1981, with the following capital structure:

10% cumulative preferred stock, par and liquidation value $100; authorized, issued, and outstanding 1,000 shares	$100,000
Common stock, par value $5; authorized 20,000 shares; issued and outstanding 10,000 shares	50,000

Ventura's net income for the year ended December 31, 1981, was $450,000, but no dividends were declared. How much was Ventura's book value per common share at December 31, 1981?

a. $44
b. $45
c. $49
d. $50

6. On July 1, 1982, a fire destroyed $100,000 of Brody Company's $300,000 inventory (fair market values). Brody carried a $120,000 fire insurance policy with an 80% coinsurance clause. What is the maximum amount of insurance that Brody can collect as a result of this loss?

a. $ 50,000
b. $ 80,000
c. $ 96,000
d. $100,000

7. On January 1, 1976, Roper Corporation issued 2,000 of its 10%, $1,000 bonds for $2,080,000. These bonds were to mature on January 1, 1986, but were callable at 101 any time after December 31, 1980. Interest was payable semiannually on July 1 and January 1. On July 1, 1981, Roper called all of the bonds and retired them. Bond premium was amortized on a straight-line basis. Ignoring income taxes, how much was Roper's gain or loss in 1981 on this early extinguishment of debt?
   a. $16,000 gain.
   b. $20,000 loss.
   c. $24,000 gain.
   d. $60,000 gain.

8. In 1978, Cromwell Corporation bought 30,000 shares of Fleming Corporation's listed stock for $300,000. This stock was not accounted for by the equity method. In 1981, when the market value had declined to $200,000, Cromwell changed its classification of this investment from current to noncurrent. In January 1982, before Cromwell's 1981 year-end statements were issued, the market value of the Fleming stock had risen to $230,000. How much should Cromwell record as a realized loss in its determination of net income for 1981?
   a. $0
   b. $ 30,000
   c. $ 70,000
   d. $100,000

Items 9 and 10 are based on the following data:

Bretton Corporation's books disclosed the following information as of and for the year ended December 31, 1981:

Net credit sales	$2,000,000
Net cash sales	500,000
Merchandise purchases	1,000,000
Inventory at beginning	600,000
Inventory at end	200,000
Accounts receivable at beginning	300,000
Accounts receivable at end	700,000
Net income	100,000

9. Bretton's accounts receivable turnover is
   a. 2.9 times.
   b. 3.6 times.
   c. 4.0 times.
   d. 5.0 times.

10. Bretton's percent of net income on sales is
   a. 4%
   b. 9%
   c. 44%
   d. 56%

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11. The following information pertains to a flange that is carried in the inventory of Mills Wholesalers, Inc.:

	Per unit
Original cost	$3.00
Replacement cost	1.20
Net realizable value	2.40
Net realizable value, less normal markup	1.68

What should be the carrying value per unit on the basis of lower of cost or market?
   a. $1.20
   b. $1.68
   c. $2.40
   d. $3.00

12. Lee Corporation has a noncontributory pension plan covering substantially all of its employees. Lee's policy is to fund pension costs as accrued. At December 31, 1981, the actuarially computed value of vested benefits equalled the cash on deposit with the trustee. The total pension expense for 1981 was $900,000, which included normal cost of $700,000 and amortization of past service cost of $200,000. The unamortized balance of past service cost at December 31, 1981, was $600,000. How much should appear on Lee's balance sheet at December 31, 1981, for pension liability?
   a. $0
   b. $200,000
   c. $600,000
   d. $900,000

13. Tollner Company sold a machine to Snead Corporation on January 1, 1980, for which the cash sales price was $379,100. Snead entered into an installment sales contract with Tollner, calling for annual payments of $100,000 for five years, including interest at 10%. The first payment was due on December 31, 1980. How much interest income should be recorded by Tollner in 1981?
   a. $27,910
   b. $31,701
   c. $37,910
   d. $50,000

14. On July 1, 1982, Glendora Corporation issued $1,000,000 of 10% nonconvertible bonds at 103, due June 30, 2002. Each $1,000 bond was issued with 30 detachable stock warrants, each of which entitled the bondholder to buy one share of Glendora's $10 par value common stock for $25. On July 1, 1982, the market values of Glendora's common stock and warrants were $30 and $4, respectively. How much should Glendora record on July 1, 1982, as paid-in capital from stock warrants?
   a. $ 30,000
   b. $120,000
   c. $150,000
   d. $300,000

15. Warren Waste Products Company carries a $5,000,000 comprehensive public liability policy which contains a $50,000 deductible clause. A personal injury liability suit was brought against Warren in 1981, which probably will be settled for $75,000. How much should appear on Warren's December 31, 1981, balance sheet for contingent liabilities?

a. $0
b. $25,000
c. $50,000
d. $75,000

16. Almonte Company sold a computer in 1981 for $70,000. The computer's original cost was $250,000, and the accumulated depreciation at the date of sale was $200,000. If funds are defined as working capital, the sale of the computer should appear on Almonte's 1981 statement of changes in financial position as

a. A subtraction from net income of $20,000 and a source of $50,000.
b. An addition to net income of $20,000 and a source of $50,000.
c. A subtraction from net income of $20,000 and a source of $70,000.
d. A source of $70,000.

Items 17 and 18 are based on the following data:

At December 31, 1981 and 1980, Gravin Corporation had 90,000 shares of common stock and 20,000 shares of convertible preferred stock outstanding, in addition to 9% convertible bonds payable in the face amount of $2,000,000. During 1981, Gravin paid dividends of $2.50 per share on the preferred stock. The preferred stock is convertible into 20,000 shares of common stock, and is considered a common stock equivalent. The 9% convertible bonds are convertible into 30,000 shares of common stock, but are not considered common stock equivalents. Net income for 1981 was $970,000. Assume an income tax rate of 40%.

17. How much is the primary earnings per share for the year ended December 31, 1981?

a. $ 7.70
b. $ 8.36
c. $ 8.82
d. $10.78

18. How much is the fully diluted earnings per share for the year ended December 31, 1981?

a. $ 7.70
b. $ 8.21
c. $ 9.35
d. $10.22

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19. Gulliver Company is disposing of a segment of its business. At the measurement date the net loss from the disposal is estimated to be $475,000. Included in this $475,000 are severance pay of $50,000 and employee relocation costs of $25,000, both of which are directly associated with the decision to dispose of the segment, and estimated net operating losses of the segment from the measurement date to the disposal date of $100,000. Net losses of $75,000 from operations from the beginning of the year to the measurement date are not included in the $475,000 estimated disposal loss. Ignoring income taxes, how much should be reported on Gulliver's income statement as the total loss under the heading "Discontinued operations"?

a. $175,000
b. $425,000
c. $450,000
d. $550,000

20. On July 1, 1982, Menzie Corporation sold a $1,000,000, 20-year, 10% bond issue for $1,060,000. Each $1,000 bond had a detachable warrant eligible for the purchase of one share of Menzie's $50 par value common stock for $60. Immediately after sale of the bonds, Menzie's securities had the following market values:

10% bond without warrants	$1,040
Warrants	20
Common stock, $50 par value	56

How much should Menzie credit to premium on bonds payable?

a. $0
b. $20,000
c. $40,000
d. $60,000

Number 2 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of managerial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

21. Manor Company plans to discontinue a department with a contribution to overhead of $24,000 and allocated overhead of $48,000, of which $21,000 cannot be eliminated. The effect of this discontinuance on Manor's pretax profit would be a (an)

a. Decrease of $3,000.
b. Increase of $3,000.
c. Decrease of $24,000.
d. Increase of $24,000.

22. The following information pertains to Bates Company's direct labor for March 1982:

Standard direct labor hours	21,000
Actual direct labor hours	20,000
Favorable direct labor rate variance	$8,400
Standard direct labor rate per hour	$ 6.30

What was Bates' total actual direct labor cost for March 1982?

a. $117,600
b. $118,000
c. $134,000
d. $134,400

23. Pratt Company is preparing its cash budget for the month ending November 30, 1982. The following information pertains to Pratt's past collection experience from its credit sales:

Current month's sales	12%
Prior month's sales	75%
Sales two months prior to current month	6%
Sales three months prior to current month	4%
Cash discounts (2/30, net 90)	2%
Doubtful accounts	1%

Credit sales:

November - estimated	$200,000
October	180,000
September	160,000
August	190,000

How much is the estimated credit to accounts receivable as a result of collections expected during November?

a. $170,200
b. $174,200
c. $176,200
d. $180,200

24. Perkins Company, which has a standard cost system, had 500 units of raw material X in its inventory at June 1, 1982, purchased in May for $1.20 per unit and carried at a standard cost of $1.00. The following information pertains to raw material X for the month of June 1982:

Actual number of units purchased	1,400
Actual number of units used	1,500
Standard number of units allowed for actual production	1,300
Standard cost per unit	$1.00
Actual cost per unit	$1.10

The unfavorable materials purchase price variance for raw material X for June was

a. $0
b. $130
c. $140
d. $150

25. Brill Company manufactures products Y and Z from a joint process. Sales value at split-off was $100,000 for 6,000 units of Y and $50,000 for 2,000 units of Z. The portion of total joint costs properly allocated to Y was $60,000, using the relative-sales-value at split-off approach. How much were the total joint costs?

a. $ 80,000
b. $ 85,000
c. $ 90,000
d. $120,000

26. Pendall Company manufactures products Dee and Eff from a joint process. Product Dee has been allocated $2,500 of total joint costs of $20,000 for the 1,000 units produced. Dee can be sold at the split-off point for $3 per unit, or it can be processed further with additional costs of $1,000 and sold for $5 per unit. If Dee is processed further and sold, the result would be

a. A break-even situation.
b. An additional gain of $1,000 from further processing.
c. An overall loss of $1,000.
d. An additional gain of $2,000 from further processing.

27. Marling Company is contemplating an expansion program based on the following budget data:

Expected sales	$600,000
Variable costs	420,000
Fixed expenses	120,000

What is the amount of break-even sales?

a. $400,000
b. $420,000
c. $540,000
d. $660,000

28. Betz Company's sales budget shows the following projections for the year ending December 31, 1983:

Quarter	*Units*
First	60,000
Second	80,000
Third	45,000
Fourth	55,000
Total	240,000

Inventory at December 31, 1982, was budgeted at 18,000 units. The quantity of finished goods inventory at the end of each quarter is to equal 30% of the next quarter's budgeted sales of units. How much should the production budget show for units to be produced during the first quarter?

a. 24,000
b. 48,000
c. 66,000
d. 72,000

29. Spencer Company's regular selling price for its product is $10 per unit. Variable costs are $6 per unit. Fixed costs total $1 per unit based on 100,000 units, and remain unchanged within the relevant range of 50,000 units to total capacity of 200,000 units. After sales of 80,000 units were projected for 1982, a special order was received for an additional 10,000 units. To increase its operating income by $10,000, what price per unit should Spencer charge for this special order?
   a. $ 7
   b. $ 8
   c. $10
   d. $11

30. Keller Company, a manufacturer of rivets, uses absorption costing. Keller's 1981 manufacturing costs were as follows:

Direct materials and direct labor	$800,000
Depreciation of machines	100,000
Rent for factory building	60,000
Electricity to run machines	35,000

How much of these costs should be inventoried?
   a. $800,000
   b. $835,000
   c. $935,000
   d. $995,000

Items 31 and 32 are based on the following data:

Roja Corporation makes aluminum fasteners. Among Roja's 1981 manufacturing costs were the following:

Wages and salaries	
Machine operators	$ 80,000
Factory foremen	30,000
Machine mechanics	20,000
Materials and supplies	
Aluminum	$400,000
Machine parts	18,000
Lubricants for machines	5,000

31. Direct labor amounted to
   a. $ 80,000
   b. $100,000
   c. $110,000
   d. $130,000

32. Direct materials amounted to
   a. $400,000
   b. $405,000
   c. $418,000
   d. $423,000

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33. Purvis Company manufactures a product that has a variable cost of $50 per unit. Fixed costs total $1,000,000, allocated on the basis of the number of units produced. Selling price is computed by adding a 10% markup to full cost. How much should the selling price be per unit for 100,000 units?
   a. $55
   b. $60
   c. $61
   d. $66

34. Mori Company plans to begin production of a new product on July 1, 1983. An 80% learning curve is applicable to Mori's manufacturing operations. If it is expected to take 1,000 direct labor hours to produce the first unit, how many direct labor hours should it take to produce a total of four units?
   a. 4,000
   b. 3,200
   c. 2,560
   d. 2,048

35. The following standard costs pertain to a component part manufactured by Ashby Company:

Direct materials	$ 2
Direct labor	5
Factory overhead	20
Standard cost per unit	$27

Factory overhead is applied at $1 per standard machine hour. Fixed capacity cost is 60% of applied factory overhead, and is not affected by any "make or buy" decision. It would cost $25 per unit to buy the part from an outside supplier. In the decision to "make or buy," what is the total relevant unit manufacturing cost to be considered?
   a. $ 2
   b. $15
   c. $19
   d. $27

36. Cannon Cannery, Inc., estimated its factory overhead at $510,000 for 1981, based on a normal capacity of 100,000 direct labor hours. Standard direct labor hours for the year totaled 105,000, while the factory overhead control account at the end of the year showed a balance of $540,000. How much was the underapplied factory overhead for 1981?
   a. $0
   b. $ 4,500
   c. $27,000
   d. $30,000

Items 37 and 38 are based on the following data:

Morton Company's manufacturing costs for 1981 were as follows:

Direct materials	$300,000
Direct labor	400,000
Factory overhead:	
Variable	80,000
Fixed	50,000

37. Prime cost totaled
 a. $300,000
 b. $380,000
 c. $700,000
 d. $830,000

38. Conversion cost totaled
 a. $400,000
 b. $480,000
 c. $530,000
 d. $830,000

Items 39 and 40 are based on the following data:

Earl Corporation manufactures a product that gives rise to a by-product called "Zafa." The only costs associated with Zafa are selling costs of $1 for each unit sold. Earl accounts for Zafa sales by deducting its separable costs from such sales, and then deducting this net amount from cost of sales of the major product. In 1981, 1,000 units of Zafa were sold at $4 each.

39. If Earl changes its method of accounting for Zafa sales by showing the net amount as additional sales revenue, then Earl's gross margin would
 a. Be unaffected.
 b. Increase by $3,000.
 c. Decrease by $3,000.
 d. Increase by $4,000.

40. If Earl changes its method of accounting for Zafa sales by showing the net amount as "Other Income," then Earl's gross margin would
 a. Be unaffected.
 b. Increase by $3,000.
 c. Decrease by $3,000.
 d. Decrease by $4,000.

Number 3 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **the federal income taxation of corporations and partnerships.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. The answers should be based upon 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. Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

41. Richards Corporation had taxable income of $280,000 before deducting charitable contributions for its tax year ended December 31, 1982. The dividends received deduction was $34,000. Richards made cash contributions of $35,000 to charitable organizations. How much can Richards deduct as contributions for 1982?
 a. $28,000
 b. $31,400
 c. $32,000
 d. $35,000

42. Anderson Corporation realized taxable income of $72,000 from its regular business operations for calendar year 1981. In addition Anderson had the following capital gains and losses during 1981:

Short-term capital gain	$17,000
Short-term capital loss	(8,000)
Long-term capital gain	3,000
Long-term capital loss	(7,000)

Anderson did not realize any other capital gains or losses since it began operations. What is Anderson's total taxable income for 1981?
 a. $77,000
 b. $81,000
 c. $84,000
 d. $92,000

43. In 1981 Studley Corporation, not a dealer in securities, realized taxable income of $80,000 from the operation of its business. Additionally in 1981, Studley realized a long-term capital loss of $12,000 from the sale of marketable securities. Studley did not realize any other capital gains or losses since it began operations. What is the proper treatment for the $12,000 long-term capital loss in Studley's income tax returns?

a. Use $3,000 of the loss to reduce taxable income for 1981, and carry $9,000 of the long-term capital loss forward five years.
b. Use $6,000 of the loss to reduce taxable income by $3,000 for 1981, and carry $6,000 of the long-term capital loss forward five years.
c. Use $12,000 of the long-term capital loss to reduce taxable income by $6,000 for 1981.
d. Carry the $12,000 long-term capital loss forward five years, treating it as a short-term capital loss.

44. Barker owns a 40% interest in the capital and profits of the Murphy and Barker partnership. During 1981 Barker sold securities to the partnership for their fair market value of $36,000. Barker's adjusted tax basis in the securities was $24,000. How much gain (before any long-term capital gain deduction) should Barker recognize on this transaction on his 1981 tax return?

a. $0
b. $ 4,800
c. $ 7,200
d. $12,000

45. Prior to 1981 Carlyle Corporation used the specific charge-off method for computing its bad debt deduction. During 1981 Carlyle filed a timely request for a change to the reserve method of accounting for its bad debt deduction. The following data are available from Carlyle's records:

	Accounts receivable at end of year	*Bad debts charged off*
1976	$ 420,000	$11,500
1977	470,000	14,500
1978	500,000	15,000
1979	480,000	13,500
1980	530,000	17,500
	$2,400,000	$72,000
1981	$ 600,000	$19,500

How much should Carlyle claim as a bad debt deduction on its 1981 tax return?

a. $18,000
b. $19,500
c. $21,300
d. $37,500

46. During 1981 Culbert, Inc., made the following expenditures:

Promotional materials for use on customers' premises (1,000 @ $40)	$40,000
Business gifts to customers (60 @ $100)	6,000
Contribution to a candidate for public office	1,000

How much of the above expenditures should Culbert deduct in determining its taxable income for 1981?

a. $26,500
b. $41,500
c. $42,500
d. $47,000

47. In computing the ordinary income of a partnership reportable on the partnership return, a deduction is allowed for

a. Contributions to charitable organizations.
b. The net operating loss deduction.
c. A net short-term capital loss.
d. Guaranteed payments to partners.

48. Dorsett Corporation's income tax return for 1981 shows deductions exceeding gross income by $56,800. Included in the tax return are the following items:

Net operating loss deduction (carryover from 1980)	$15,000
Dividends received deduction	6,800

What is Dorsett's net operating loss for 1981?

a. $56,800
b. $50,000
c. $41,800
d. $35,000

49. On December 31, 1981, King Corporation distributed to Mary Spencer, its sole shareholder, as a dividend in kind, a tract of land that was not an inventory asset. Immediately prior to the distribution on December 31, 1981, the following data were available:

Adjusted basis of the land	$30,000
Fair market value of the land	25,000
Accumulated earnings and profits	50,000

By how much should the dividend distribution reduce King's accumulated earnings and profits?

a. $20,000
b. $25,000
c. $30,000
d. $35,000

50. For the year ended December 31, 1981, Atkinson, Inc., had gross business income of $160,000 and dividend income of $100,000 from unaffiliated domestic corporations. Business deductions for 1981 amounted to $170,000. What is Atkinson's dividends received deduction for 1981?
    a. $0
    b. $76,500
    c. $85,000
    d. $90,000

51. Martin Corporation purchased a machine for $550,000 on January 1, 1979. Martin sold the machine for $450,000 on December 31, 1981, at which date the accumulated depreciation amounted to $270,000. How much should Martin report as a section 1231 gain for the year ended December 31, 1981?
    a. $0
    b. $ 85,000
    c. $100,000
    d. $170,000

52. Keller, Inc., a Subchapter S corporation, has three equal shareholders. For the year ended December 31, 1981, Keller had taxable income and current earnings and profits of $150,000. Keller made cash distributions totaling $60,000 during 1981. For the calendar year 1981, what amount should be included in each shareholder's gross income from Keller?
    a. $20,000
    b. $30,000
    c. $50,000
    d. $70,000

53. Bishop Corporation reported taxable income of $700,000 on its federal income tax return for calendar year 1981. Selected information for 1981 is available from Bishop's records as follows:

Provision for federal income tax per books	$280,000
Depreciation claimed on the tax return	130,000
Depreciation recorded in the books	75,000
Life insurance proceeds on death of corporate officer	100,000

Bishop reported net income per books for 1981 of
    a. $855,000
    b. $595,000
    c. $575,000
    d. $475,000

54. On April 1, 1982, Crowe and Greene formed Apex Corporation. The same day Crowe paid $150,000 for 500 shares of Apex common stock, and Greene transferred land and building to Apex in exchange for 500 shares of common stock. The land and building had an adjusted basis to Greene of $120,000, a fair market value of $200,000, and was subject to a mortgage of $60,000 on April 1, 1982. The mortgage was assumed by Apex. Apex had no other shares of stock outstanding on April 1, 1982. The basis of the land and building to Apex on April 1, 1982, is
    a. $ 60,000
    b. $120,000
    c. $140,000
    d. $150,000

55. Pursuant to a plan of reorganization adopted in 1981, Summit Corporation exchanged 1,000 shares of its common stock and paid $40,000 cash for Hansen Corporation assets with an adjusted basis of $200,000 (fair market value of $300,000). The 1,000 shares of Summit common stock had a fair market value of $260,000 on the date of the exchange. What is the basis to Summit of the assets acquired in the exchange?
    a. $200,000
    b. $240,000
    c. $260,000
    d. $300,000

56. Grant Corporation, a Subchapter S corporation, had taxable income and current earnings and profits of $36,000 for the year ended December 31, 1981. Included in the above is $24,000 excess net long-term capital gain over net short-term capital loss. Cash distributions to Mr. Hamlin, the sole shareholder, totaled $72,000 during 1981. On December 31, 1980, Grant had accumulated earnings and profits of $60,000, none of which had been previously taxed. What amount should Hamlin report on his 1981 individual income tax return as long-term gain passed through from Grant?
    a. $0
    b. $ 8,000
    c. $12,000
    d. $24,000

57. Foster Corporation's tax liability for the year ended December 31, 1981, was $15,000 before claiming an investment tax credit. On July 1, 1981, Foster purchased a new truck for $180,000. The truck is appropriately categorized by Foster as five-year property under the accelerated cost recovery system. Foster's allowed investment tax credit for 1981 is
    a. $ 9,000
    b. $12,000
    c. $15,000
    d. $18,000

58. Browne and Whelan form a partnership on January 1, 1982, agreeing to share capital and profits equally. Browne contributes $23,000 cash. Whelan contributes land with an adjusted basis to him of $10,000 and a fair market value of $25,000 on January 1, 1982. The land is subject to a $2,000 mortgage which is assumed by the partnership. Whelan's tax basis in the partnership on January 1, 1982, should be

a. $ 8,000
b. $ 9,000
c. $10,000
d. $23,000

59. Edgewood Corporation was liquidated in 1981 by Roberts, its sole shareholder. Pursuant to the liquidation, Roberts' stock in Edgewood was cancelled and he received the following assets on July 15, 1981:

	Basis to Edgewood	*Fair market value*
Cash	$ 40,000	$ 40,000
Accounts receivable	20,000	20,000
Inventory	30,000	45,000
Land	50,000	75,000
	$140,000	$180,000

How much gain should be recognized by Edgewood Corporation on the liquidation?

a. $0
b. $15,000
c. $25,000
d. $40,000

60. On November 30, 1981, Diamond's adjusted basis for his one-third interest in the capital and profits of Peterson and Company was $95,000 ($80,000 capital account plus $15,000 share of partnership liabilities). On that date Diamond sold his partnership interest to Girard for $120,000 cash and the assumption of Diamond's share of the partnership liabilities. What amount and type of gain should Diamond recognize in 1981 from the sale of his partnership interest?

	Amount	*Type of gain*
a.	$25,000	Ordinary income
b.	$25,000	Capital gain
c.	$40,000	Ordinary income
d.	$40,000	Capital gain

Number 4 (Estimated time —— 45 to 55 minutes)

In January 1982, you began the examination of the financial statements for the year ended December 31, 1981, of Howe Corporation, a new audit client. During your examination the following information was disclosed:

- On January 2, 1979, packaging equipment was purchased at a cost of $450,000. The equipment had an estimated useful life of five years and a salvage value of $60,000. Howe was entitled to and claimed an investment credit of $30,000 on its 1979 income tax return. For financial reporting purposes, the investment credit was treated as an offset against the cost of the equipment. The sum-of-the-years' digits method of depreciation was used for income tax reporting and the straight-line method was used on the financial statements.
- On January 3, 1980, $120,000 was collected in advance rental of a building for a three-year period. The $120,000 was reported as taxable income in 1980, but $80,000 was reported as deferred revenue in 1980 in the financial statements. The building will continue to be rented for the foreseeable future.
- On February 9, 1981, Howe sold land with a book and tax basis of $300,000 for $400,000. The gain, reported in full in 1981 on the financial statements, was reported by the installment method on the income tax return equally over a period of ten years and is taxable at the capital gains rate.
- On March 10, 1981, a patent was purchased at a cost of $68,000. Howe is amortizing the patent over a period of four years on the financial statements and over 17 years on its income tax return. Howe elected to record a full year's amortization in 1981 on both its financial statements and income tax return.

Based on effective income tax rates of 40% on ordinary income and 28% on long-term capital gains, the following federal income tax liabilities were reported on Howe's income tax returns:

1979	$ 50,000
1980	142,400
1981	101,280

Required:

Prepare schedules computing

1. Net deductions for tax reporting purposes, giving rise to interperiod tax allocation on ordinary income for each year ended December 31, 1979, 1980, and 1981.
2. Net deductions for financial statements adjusted for applicable permanent differences, giving rise to interperiod tax allocation on ordinary income for each year ended December 31, 1979, 1980, and 1981.
3. Deferred tax credit at the capital gains rate at December 31, 1981.
4. Total net deferred tax credits and debits at December 31, 1979, 1980, and 1981.
5. Total income tax expense for financial statement purposes for each year ended December 31, 1979, 1980, and 1981.

Number 5 (Estimated time ---- 40 to 50 minutes)

The following selected information was taken from the books and records of Glendora Hospital (a voluntary hospital) as of and for the year ended June 30, 1982:

- Patient service revenue totaled $16,000,000, with allowances and uncollectible accounts amounting to $3,400,000. Other operating revenue aggregated $346,000, and included $160,000 from specific purpose funds. Revenue of $6,000,000 recognized under cost reimbursement agreements is subject to audit and retroactive adjustment by third-party payors. Estimated retroactive adjustments under these agreements have been included in allowances.

- Unrestricted gifts and bequests of $410,000 were received.

- Unrestricted income from endowment funds totaled $160,000.

- Income from board-designated funds aggregated $82,000.

- Operating expenses totaled $13,370,000, and included $500,000 for depreciation computed on the straight-line basis. However, accelerated depreciation is used to determine reimbursable costs under certain third-party reimbursement agreements. Net cost reimbursement revenue amounting to $220,000, resulting from the difference in depreciation methods, was deferred to future years.

- Also included in operating expenses are pension costs of $100,000, in connection with a noncontributory pension plan covering substantially all of Glendora's employees. Accrued pension costs are funded currently. Prior service cost is being amortized over a period of 20 years. The actuarially computed value of vested and nonvested benefits at year-end amounted to $3,000,000 and $350,000 respectively. The assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 8%. The plan's net assets available for benefits at year-end was $3,050,000.

- Gifts and bequests are recorded at fair market values when received.

- Patient service revenue is accounted for at established rates on the accrual basis.

Required:

1. Prepare a formal statement of revenues and expenses for Glendora Hospital for the year ended June 30, 1982.

2. Draft the appropriate disclosures in separate notes accompanying the statement of revenues and expenses, referencing each note to its respective item in the statement.

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN AUDITING

November 4, 1982; 8:30 A.M. to 12:00 M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	90	110
No. 2	15	25
No. 3	15	25
No. 4	15	25
No. 5	15	25
Total	150	210

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers.

3. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 90 to 110 minutes)

Instructions

Select the **best** answer for each of the following items. Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

96. One of the generally accepted auditing standards specifies that the auditor should
    a. Inspect all fixed assets acquired during the year.
    b. Charge fair fees based on cost.
    c. Make a proper study and evaluation of the existing internal control.
    d. Count client petty-cash funds.

Answer Sheet

96. ⓐ ⓑ ● ⓓ

Items to be Answered

1. Negative assurance is **not** permissible in
    a. Letters required by security underwriters for data pertinent to SEC registration statements.
    b. Reports relating to the results of agreed upon procedures to one or more specified elements, accounts, or items of a financial statement.
    c. Reports based upon a review engagement.
    d. Reports based upon an audit of the interim financial statements of a closely-held business entity.

2. An audit independence issue might be raised by the auditor's participation in management advisory services engagements. Which of the following statements is **most** consistent with the profession's attitude toward this issue?
    a. Information obtained as a result of a management advisory services engagement is confidential to that specific engagement and should **not** influence performance of the attest function.
    b. The decision as to loss of independence must be made by the client based upon the facts of the particular case.
    c. The auditor should **not** make management decisions for an audit client.
    d. The auditor who is asked to review management decisions is also competent to make these decisions and can do so without loss of independence.

3. At which point in an ordinary sales transaction of a wholesaling business would a lack of specific authorization be of **least** concern to the auditor in the conduct of an audit?
    a. Granting of credit.
    b. Shipment of goods.
    c. Determination of discounts.
    d. Selling of goods for cash.

4. Comparative financial statements include the financial statements of a prior period which were examined by a predecessor auditor, whose report is **not** presented. If the predecessor auditor's report was qualified, the successor auditor must
    a. Express an opinion on the current year statements alone and make **no** reference to the prior year statements.
    b. Disclose the reasons for any qualification included in the predecessor auditor's opinion.
    c. Obtain written approval from the predecessor auditor, to include the prior year's financial statements.
    d. Issue a standard short-form comparative report indicating the division of responsibility.

5. Higgins Corporation is required to but does not wish to prepare and issue a statement of changes in financial position along with its other basic financial statements. In these circumstances, the independent auditor's report on the Higgins' financial statements should include a (an)
    a. Unqualified opinion with a statement of changes in financial position prepared by the auditor and included as part of the auditor's report.
    b. Qualified opinion with a middle paragraph explaining that the company declined to present the required statement.
    c. Adverse opinion stating that the financial statements, taken as a whole, are **not** fairly presented because of the omission of the required statement.
    d. Disclaimer of opinion with a separate explanatory paragraph stating why the company declined to present the required statement.

6. The letter of audit inquiry addressed to the client's legal counsel will **not** ordinarily be
    a. Sent to a lawyer who was engaged by the audit client during the year and soon thereafter resigned the engagement.
    b. A source of corroboration of the information originally obtained from management concerning litigation, claims, and assessments.
    c. Limited to references concerning only pending or threatened litigation with respect to which the lawyer has been engaged.
    d. Needed during the audit of clients whose securities are **not** registered with the SEC.

7. What is the responsibility of a successor auditor with respect to communicating with the predecessor auditor in connection with a prospective new audit client?
   a. The successor auditor has **no** responsibility to contact the predecessor auditor.
   b. The successor auditor should obtain permission from the prospective client to contact the predecessor auditor.
   c. The successor auditor should contact the predecessor regardless of whether the prospective client authorizes contact.
   d. The successor auditor need **not** contact the predecessor if the successor is aware of all available relevant facts.

8. As a result of analytical review procedures, the independent auditor determines that the gross profit percentage has declined from 30% in the preceding year to 20% in the current year. The auditor should
   a. Express an opinion which is qualified due to inability of the client company to continue as a going concern.
   b. Evaluate management's performance in causing this decline.
   c. Require footnote disclosure.
   d. Consider the possibility of an error in the financial statements.

9. The auditor is examining copies of sales invoices only for the initials of the person responsible for checking the extensions. This is an example of a
   a. Compliance test.
   b. Substantive test.
   c. Dual purpose test.
   d. Test of balances.

10. When an outside specialist has assumed full responsibility for taking the client's physical inventory, reliance on the specialist's report is acceptable if
   a. The auditor is satisfied through application of appropriate procedures as to the reputation and competence of the specialist.
   b. Circumstances made it impracticable or impossible for the auditor either to do the work personally or observe the work done by the inventory firm.
   c. The auditor conducted the same audit tests and procedures as would have been applicable if the client employees took the physical inventory.
   d. The auditor's report contains a reference to the assumption of full responsibility.

11. The auditor is **least** concerned with which of the following?
   a. Administrative controls.
   b. Application controls.
   c. Safeguarding of assets.
   d. Access to assets.

12. Which of the following factors will **least** affect the independent auditor's judgment as to the quantity, type, and content of working papers desirable for a particular engagement?
   a. Nature of the auditor's report.
   b. Nature of the financial statements, schedules, or other information upon which the auditor is reporting.
   c. Need for supervision and review.
   d. Number of personnel assigned to the audit.

13. An auditor's working papers will generally be **least** likely to include documentation showing how the
   a. Client's schedules were prepared.
   b. Engagement had been planned.
   c. Client's system of internal control had been reviewed and evaluated.
   d. Unusual matters were resolved.

14. In a study of the system of internal control the completion of a questionnaire is most closely associated with which of the following?
   a. Separation of duties.
   b. Review of the system.
   c. Flowchart accuracy.
   d. Tests of compliance.

15. In pursuing a CPA firm's quality control objectives, a CPA firm may maintain records indicating which partners or employees of the CPA firm were previously employed by the CPA firm's clients. Which quality control objective would this be **most** likely to satisfy?
   a. Professional relationship.
   b. Supervision.
   c. Independence.
   d. Advancement.

16. Which of the following procedures relating to the examination of accounts payable could the auditor delegate entirely to the client's employees?
   a. Test footings in the accounts payable ledger.
   b. Reconcile unpaid invoices to vendors' statements.
   c. Prepare a schedule of accounts payable.
   d. Mail confirmations for selected account balances.

17. A material change in an accounting estimate
   a. Requires a consistency modification in the auditor's report and disclosure in the financial statements.
   b. Requires a consistency modification in the auditor's report but does **not** require disclosure in the financial statements.
   c. Affects comparability and may require disclosure in a note to the financial statements but does **not** require a consistency modification in the auditor's report.
   d. Involves the acceptability of the generally acceptable accounting principles used.

18. Which of the following audit procedures is **least** likely to detect an unrecorded liability?
    a. Analysis and recomputation of interest expense.
    b. Analysis and recomputation of depreciation expense.
    c. Mailing of standard bank confirmation form.
    d. Reading of the minutes of meetings of the board of directors.

19. When a customer fails to include a remittance advice with a payment, it is a common practice for the person opening the mail to prepare one. Consequently, mail should be opened by which of the following four company employees?
    a. Credit manager.
    b. Receptionist.
    c. Sales manager.
    d. Accounts receivable clerk.

20. The term "special reports" may include all of the following, **except** reports on financial statements
    a. Of an organization that has limited the scope of the auditor's examination.
    b. Prepared for limited purposes such as a report that relates to only certain aspects of financial statements.
    c. Of a not-for-profit organization which follows accounting practices differing in some respects from those followed by business enterprises organized for profit.
    d. Prepared in accordance with historical cost/constant dollar accounting.

21. If a separate statement of changes in stockholders' equity accounts accompanies the traditional financial statements, the auditor must
    a. Make no mention of this additional statement in the auditor's report.
    b. Mention this additional statement in the opinion paragraph.
    c. Mention this additional statement in the scope paragraph.
    d. Mention this additional statement in both the scope and opinion paragraphs.

22. An auditor will be **least** likely to use a negative accounts receivable confirmation form when
    a. Internal control surrounding accounts receivable is effective.
    b. A large number of small balances are involved.
    c. The number of requests mailed will be minimal.
    d. Customers are unlikely to confirm the information.

23. Morgan, CPA, is the principal auditor for a multinational corporation. Another CPA has examined and reported on the financial statements of a significant subsidiary of the corporation. Morgan is satisfied with the independence and professional reputation of the other auditor, as well as the quality of the other auditor's examination. With respect to Morgan's report on the consolidated financial statements, taken as a whole, Morgan
    a. Must **not** refer to the examination of the other auditor.
    b. Must refer to the examination of the other auditor.
    c. May refer to the examination of the other auditor.
    d. May refer to the examination of the other auditor, in which case Morgan must include in the auditor's report on the consolidated financial statements a qualified opinion with respect to the examination of the other auditor.

24. When considering internal control, an auditor must be aware of the concept of reasonable assurance which recognizes that the
    a. Employment of competent personnel provides assurance that the objectives of internal control will be achieved.
    b. Establishment and maintenance of a system of internal control is an important responsibility of the management and **not** of the auditor.
    c. Cost of internal control should **not** exceed the benefits expected to be derived from internal control.
    d. Segregation of incompatible functions is necessary to ascertain that the internal control is effective.

25. The date of the management representation letter should coincide with the
    a. Date of the auditor's report.
    b. Balance sheet date.
    c. Date of the latest subsequent event referred to in the notes to the financial statements.
    d. Date of the engagement agreement.

26. Which of the following would be **least** likely to suggest to an auditor that the client's management may have overridden the internal control system?
    a. Differences are always disclosed on a computer exception report.
    b. Management does **not** correct internal control weaknesses that it knows about.
    c. There have been two new controllers this year.
    d. There are numerous delays in preparing timely internal financial reports.

27. The reliance placed on substantive tests in relation to the reliance placed on internal control varies in a relationship that is ordinarily
    a. Parallel.
    b. Inverse.
    c. Direct.
    d. Equal.

28. Audit evidence can come in different forms with different degrees of persuasiveness. Which of the following is the **least** persuasive type of evidence?
    a. Vendor's invoice.
    b. Bank statement obtained from the client.
    c. Computations made by the auditor.
    d. Prenumbered client invoices.

29. An auditor will ordinarily ascertain whether payroll checks are properly endorsed during the examination of
    a. Time cards.
    b. The voucher system.
    c. Cash in bank.
    d. Accrued payroll.

30. A company holds bearer bonds as a short-term investment. Responsibility for custody of these bonds and submission of coupons for periodic interest collections probably should be delegated to the
    a. Chief Accountant.
    b. Internal Auditor.
    c. Cashier.
    d. Treasurer.

31. When obtaining evidence regarding litigation against a client, the CPA would be **least** interested in determining
    a. An estimate of when the matter will be resolved.
    b. The period in which the underlying cause of the litigation occurred.
    c. The probability of an unfavorable outcome.
    d. An estimate of the potential loss.

32. One of the major problems in an EDP system is that incompatible functions may be performed by the same individual. One compensating control for this is use of
    a. A tape library.
    b. A self-checking digit system.
    c. Computer generated hash totals.
    d. A computer log.

33. A client will not make essential post balance sheet date corporate minutes available to the auditor. Because of this the audit report will probably contain a (an)
    a. Adequate disclosure of this fact.
    b. Adverse opinion.
    c. Qualified opinion.
    d. Disclaimer with respect to subsequent events.

34. When reporting on financial statements that are required to include segment information, the auditor's quantitative measurement of materiality with respect to segment information should be
    a. Disclosed.
    b. Primarily related to the segment information alone.
    c. Primarily related to the financial statements taken as a whole.
    d. Disregarded.

35. After an auditor has issued an audit report on a nonpublic entity, there is no obligation to make any further audit tests or inquiries with respect to the audited financial statements covered by that report **unless**
    a. New information comes to the auditor's attention concerning an event which occurred prior to the date of the auditor's report which may have affected the auditor's report.
    b. Material adverse events occur after the date of the auditor's report.
    c. Final determination or resolution was made on matters which had resulted in a qualification in the auditor's report.
    d. Final determination or resolution was made of a contingency which had been disclosed in the financial statements.

36. When financial statements of a prior period are presented on a comparative basis with financial statements of the current period, the continuing auditor is responsible for
    a. Expressing dual dated opinions.
    b. Updating the report on the previous financial statements only if there has **not** been a change in the opinion.
    c. Updating the report on the previous financial statements only if the previous report was qualified and the reasons for the qualification no longer exist.
    d. Updating the report on the previous financial statements regardless of the opinion previously issued.

37. Skates, an independent auditor, was engaged to perform an examination of the financial statements of Apex Incorporated one month after its fiscal year had ended. Although the inventory count was not observed by Skates, and accounts receivable were not confirmed by direct communication with debtors, Skates was able to gain satisfaction by applying alternative auditing procedures. Skates' auditor's report will probably contain
    a. An "except for" qualification.
    b. An unqualified opinion and an explanatory middle paragraph.
    c. Either a qualified opinion or a disclaimer of opinion.
    d. A standard unqualified opinion.

38. Which of the following is **not** a characteristic of a batch processed computer system?
    a. The collection of like transactions which are sorted and processed sequentially against a master file.
    b. Keypunching of transactions, followed by machine processing.
    c. The production of numerous printouts.
    d. The posting of a transaction, as it occurs, to several files, without intermediate printouts.

39. In performing a compilation of financial statements of a nonpublic entity, the accountant decides that modification of the standard report is not adequate to indicate deficiencies in the financial statements taken as a whole, and the client is not willing to correct the deficiencies. The accountant should therefore
    a. Perform a review of the financial statements.
    b. Issue a special report.
    c. Withdraw from the engagement.
    d. Express an adverse audit opinion.

40. Which of the following is true of generalized audit software packages?
    a. They can be used only in auditing on-line computer systems.
    b. They can be used on any computer without modification.
    c. They each have their own characteristics which the auditor must carefully consider before using in a given audit situation.
    d. They enable the auditor to perform all manual compliance test procedures less expensively.

41. An accountant's compilation report should be dated as of the date of
    a. Completion of fieldwork.
    b. Completion of the compilation.
    c. Transmittal of the compilation report.
    d. The latest subsequent event referred to in the notes to the financial statements.

42. The auditor who becomes aware of a material weakness in internal control is required to communicate this to the
    a. Audit committee and client's legal counsel.
    b. Board of directors and internal auditors.
    c. Senior management and board of directors.
    d. Internal auditors and senior management.

43. It is **not** appropriate for the auditor's report to refer a reader to a financial statement footnote for details regarding a (an)
    a. Change in accounting principle.
    b. Limitation in the scope of the audit.
    c. Uncertainty.
    d. Related party transaction.

44. A typical objective of an operational audit is for the auditor to
    a. Determine whether the financial statements fairly present the entity's operations.
    b. Evaluate the feasibility of attaining the entity's operational objectives.
    c. Make recommendations for improving performance.
    d. Report on the entity's relative success in attaining profit maximization.

45. Which of the following is implied when a CPA signs the preparer's declaration on a federal income tax return?
    a. The tax return is **not** misleading based on all information of which the CPA has knowledge.
    b. The tax return and supporting schedules were prepared in accordance with generally accepted accounting principles.
    c. The tax return was examined in accordance with standards established by the AICPA's Federal Tax Division.
    d. The tax return was prepared by a CPA who maintained an impartial attitude.

46. A member of the AICPA should sign the preparer's declaration on a federal income tax return
    a. Only when the CPA prepares a tax return for compensation.
    b. Only when the CPA can declare that a tax is based on all information of which the CPA has knowledge.
    c. Whenever the CPA prepares a tax return for others.
    d. Only when the income tax regulations provide that the CPA should sign the preparer's declaration.

47. In determining independence with respect to any audit engagement, the ultimate decision as to whether or **not** the auditor is independent must be made by the
    a. Auditor.
    b. Client.
    c. Audit committee.
    d. Public.

48. A CPA certificate is evidence of
    a. Recognition of independence.
    b. Basic competence at the time the certificate is granted.
    c. Culmination of the educational process.
    d. Membership in the AICPA.

49. An individual just entering upon an auditing career must obtain professional experience primarily in order to achieve a
    a. Positive quality control review.
    b. Seasoned judgment.
    c. Favorable peer review.
    d. Specialty designation by the AICPA.

50. Which of the following would **lessen** internal control in an electronic data processing system?
   a. The computer librarian maintains custody of computer program instructions and detailed program listings.
   b. Computer operators have access to operator instructions and detailed program listings.
   c. The control group maintains sole custody of all computer output.
   d. Computer programmers write and debug programs which perform routines designed by the systems analyst.

51. An auditor engaged to report on internal accounting control, distinguishes between primary control procedures and secondary control procedures. Primary control procedures are designed to achieve one or more specific objectives of a system of internal accounting control. Which of the following would be a primary control procedure?
   a. Comparison of receiving reports with vendor invoices prior to payment.
   b. Comparison of budgeted costs for direct labor with actual costs for direct labor.
   c. Comparison of actual costs for raw materials with standard costs for raw materials.
   d. Comparison of the cost of goods sold with credit sales.

52. An auditor compares information on canceled checks with information contained in the cash disbursement journal. The objective of this test is to determine that
   a. Recorded cash disbursement transactions are properly authorized.
   b. Proper cash purchase discounts have been recorded.
   c. Cash disbursements are for goods and services actually received.
   d. **No** discrepancies exist between the data on the checks and the data in the journal.

53. An auditor has withdrawn from an audit engagement of a publicly-held company after finding irregularities which may materially affect the financial statements. The auditor should set forth the reasons and findings in correspondence to the
   a. Securities and Exchange Commission.
   b. Client's legal counsel.
   c. Stock exchanges where the company's stock is traded.
   d. Board of directors.

54. In attribute sampling, a 10% change in which of the following factors normally will have the **least** effect on the size of a statistical sample?
   a. Population size.
   b. Precision (confidence interval).
   c. Reliability (confidence level).
   d. Standard deviation.

55. To verify that all sales transactions have been recorded, a test of transactions should be completed on a representative sample drawn from
   a. Entries in the sales journal.
   b. The billing clerk's file of sales orders.
   c. A file of duplicate copies of sales invoices for which all prenumbered forms in the series have been accounted for.
   d. The shipping clerk's file of duplicate copies of bills of lading.

56. Ajax Inc., is an affiliate of the audit client and is audited by another firm of auditors. Which of the following is **most** likely to be used by the auditor to obtain assurance that all guarantees of the affiliate's indebtedness have been detected?
   a. Send the standard bank confirmation request to all of the client's lender banks.
   b. Review client minutes and obtain a representation letter.
   c. Examine supporting documents for all entries in intercompany accounts.
   d. Obtain written confirmation of indebtedness from the auditor of the affiliate.

57. If preparation of a periodic scrap report is essential in order to maintain adequate control over the manufacturing process, the data for this report should be accumulated in the
   a. Accounting department.
   b. Production department.
   c. Warehousing department.
   d. Budget department.

58. Which of the following **best** describes the reference to the expression "taken as a whole" in the fourth generally accepted auditing standard of reporting?
   a. It applies equally to a complete set of financial statements and to each individual financial statement.
   b. It applies only to a complete set of financial statements.
   c. It applies equally to each item in each financial statement.
   d. It applies equally to each material item in each financial statement.

59. When an auditor issues an unqualified opinion on an entity's system of internal accounting control, it is implied that the
   a. Entity has **not** violated provisions of the Foreign Corrupt Practices Act.
   b. Likelihood of management fraud is minimal.
   c. Financial records are sufficiently reliable to permit the preparation of financial statements.
   d. Entity's system of internal accounting control is in conformity with criteria established by its audit committee.

60. The auditor is unable to reach a conclusion as to the propriety of management's representations. The auditor will have to consider issuing a (an)
    a. Opinion qualified because of uncertainty.
    b. Opinion qualified because of inadequate disclosure.
    c. Adverse opinion or a qualified opinion.
    d. Qualified opinion or a disclaimer of opinion.

Number 2 (Estimated time —— 15 to 25 minutes)

Jiblum, CPA, is planning to use attribute sampling in order to determine the degree of reliance to be placed on an audit client's system of internal accounting control over sales. Jiblum has begun to develop an outline of the main steps in the sampling plan as follows:

1. State the objective(s) of the audit test (e.g. to test the reliability of internal accounting controls over sales).
2. Define the population (define the period covered by the test; define the sampling unit, define the completeness of the population).
3. Define the sampling unit (e.g. client copies of sales invoices).

Required:

a. What are the remaining steps in the above outline which Jiblum should include in the statistical test of sales invoices? **Do not present a detailed analysis of tasks which must be performed to carry out the objectives of each step. Parenthetical examples need not be provided.**

b. How does statistical methodology help the auditor to develop a satisfactory sampling plan?

Number 3 (Estimated time —— 15 to 25 minutes)

Trapan Retailing Inc., has decided to diversify operations by selling through vending machines. Trapan's plans call for the purchase of 312 vending machines which will be situated at 78 different locations, within one city, and the rental of a warehouse to store merchandise. Trapan intends to sell only canned beverages at a standard price.

Management has hired an inventory control clerk to oversee the warehousing functions, and two truck drivers who will periodically fill the machines with merchandise, and deposit cash collected at a designated bank. Drivers will be required to report to the warehouse daily.

Required:

What internal controls should the auditor expect to find in order to assure the integrity of the cash receipts and warehousing functions?

Number 4 (Estimated time —— 15 to 25 minutes)

Andrews, CPA, has been engaged to examine the financial statements of Broadwall Corporation for the year ended December 31, 1981. During the year, Broadwall obtained a long-term loan from a local bank pursuant to a financing agreement which provided that the:

1. Loan was to be secured by the company's inventory and accounts receivable.
2. Company was to maintain a debt to equity ratio not to exceed two to one.
3. Company was not to pay dividends without permission from the bank.
4. Monthly installment payments were to commence July 1, 1981.

In addition, during the year the company also borrowed, on a short-term basis, from the president of the company, including substantial amounts just prior to the year end.

Required:

a. For purposes of Andrews' audit of the financial statements of Broadwall Corporation, what procedures should Andrews employ in examining the described loans? **Do not discuss internal control.**

b. What are the financial statement disclosures that Andrews should expect to find with respect to the loans from the president?

Number 5 (Estimated time —— 15 to 25 minutes)

For the year ended December 31, 1980, Novak & Co., CPAs, audited the financial statements of Tillis Ltd., and expressed an unqualified opinion dated February 27, 1981.

For the year ended December 31, 1981, Novak & Co., were engaged by Tillis Ltd., to review Tillis Ltd's financial statements, i.e., "look into the company's financial statements and determine whether there are any obvious modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles."

Novak made the necessary inquiries, performed the necessary analytical procedures, and performed certain additional procedures that were deemed necessary to achieve the requisite limited assurance. Novak's work was completed on March 3, 1982, and the financial statements appeared to be in conformity with generally accepted accounting principles which were consistently applied. The report was prepared on March 5, 1982. It was delivered to Jones, the controller of Tillis Ltd., on March 9, 1982.

Required:

Prepare the properly addressed and dated report on the comparative financial statements of Tillis Ltd., for the years ended December 31, 1980 and 1981.

Uniform Certified Public Accountant Examination

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN BUSINESS LAW

(Commercial Law)

November 5, 1982; 8:30 A.M. to 12:00 M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* Minimum	*Estimated Minutes* Maximum
No. 1	110	130
No. 2	15	20
No. 3	15	20
No. 4	15	20
No. 5	15	20
Total	170	210

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers.

3. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 110 to 130 minutes)

Instructions

Select the **best** answer for each of the following items. Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

99. The text of the letter from Bridge Builders, Inc., to Allied Steel Co. follows:

> We offer to purchase 10,000 tons of No. 4 steel pipe at today's quoted price for delivery two months from today. Your acceptance must be received in five days.

Bridge Builders intended to create a (an)

a. Option contract.
b. Unilateral contract.
c. Bilateral contract.
d. Joint contract.

Answer Sheet

99. ⓐ ⓑ ● ⓓ

Items to be Answered

1. On October 1, 1982, Arthur mailed to Madison an offer to sell a tract of land located in Summerville for $13,000. Acceptance was to be not later than October 10. Madison posted his acceptance on the 6th of October. The acceptance arrived on October 7th. On October 4th, Arthur sold the tract in question to Larson and mailed to Madison notice of the sale. That letter arrived on the 6th of October, but after Madison had dispatched his letter of acceptance. Which of the following is correct?
   a. There was a valid acceptance of the Arthur offer on the day Madison posted his acceptance.
   b. Arthur's offer was effectively revoked by the sale of the tract of land to Larson on the 4th of October.
   c. Arthur could **not** revoke the offer to sell the land until after October 10th.
   d. Madison's acceptance was **not** valid since he was deemed to have notice of revocation prior to the acceptance.

2. Harris wrote Douglas a letter which might be construed alternatively as an offer to sell land, an invitation to commence negotiations, or merely an invitation to Douglas to make an offer. Douglas claims that the communication was a bona fide offer which he has unequivocally accepted according to the terms set forth therein. In deciding the dispute in question, the court will
   a. Look to the subjective intent of Harris.
   b. Use an objective standard based on how a reasonably prudent businessman would have interpreted the letter to Douglas.
   c. Decide that an offer had **not** been made if any of the usual terms were omitted.
   d. Decide on the basis of what Douglas considered the writing to be.

3. Starbuck Corporation sent Crane Company an offer by a telegram to buy its patent on a calculator. The Starbuck telegram indicated that the offer would expire in ten days. The telegram was sent on February 1, 1982, and received on February 2, 1982, by Crane. On February 8, 1982, Starbuck telephoned Crane and indicated it was withdrawing the offer. Crane telegraphed an acceptance on the 11th of February. Which of the following is correct?
   a. Starbuck's withdrawal of the offer was ineffective because it was **not** in writing.
   b. The offer was an irrevocable offer, but Crane's acceptance was too late.
   c. No contract arose since Starbuck effectively revoked the offer on February 8, 1982.
   d. Since Crane used the same means of communication, acceptance was both timely and effective.

4. Calvin Poultry Co. offered to sell Chickenshop 20,000 pounds of chicken at 40 cents per pound under specified delivery terms. Chickenshop accepted the offer as follows:

   > "We accept your offer for 20,000 pounds of chicken at 40 cents per pound per city scale weight certificate."

   Which of the following is correct?
   a. A contract was formed on Calvin's terms.
   b. Chickenshop's reply constitutes a conditional acceptance, but **not** a counteroffer.
   c. Chickenshop's reply constitutes a counteroffer and **no** contract was formed.
   d. A contract was formed on Chickenshop's terms.

5. The apparent authority of an agent would **not** be determined by reference to
   a. Prior dealings between the parties.
   b. The types of activity engaged in by the agent.
   c. An undisclosed limitation on the agent's usual power.
   d. Industry custom.

6. In which of the following situations would an oral agreement without any consideration be binding under the Uniform Commercial Code?
   a. A renunciation of a claim or right arising out of an alleged breach.
   b. A firm offer by a merchant to sell or buy goods which gives assurance that it will be held open.
   c. An agreement which is a requirements contract.
   d. An agreement which modifies an existing sales contract.

7. Davidson is the agent of Myers, a fuel dealer. Myers is an undisclosed principal. Davidson contracts with Wallop to purchase 30,000 tons of coal at $20 per ton. Which of the following is correct?
   a. If Davidson acts outside the scope of his authority in entering into this contract, Myers can **not** ratify the contract.
   b. Wallop is bound to this contract only if Davidson acts within the scope of his authority.
   c. If Davidson acts within the scope of his authority, Wallop can **not** hold Davidson personally liable on the contract.
   d. Should Davidson refuse to accept delivery of the coal, Wallop will become an agent of Myers by substitution.

8. Patton is a partner in an accounting firm. His partnership contract contains a clause which states that should Patton leave the firm, he agrees not to compete with the firm for one year, either as an individual or as a member of another accounting firm, anywhere within the city limits of New York City. The accounting firm does most of its business with clients in the states of New York, Pennsylvania and New Jersey. The clause would be held
   a. Legally enforceable in most states.
   b. An illegal restraint of trade under federal antitrust statutes.
   c. Illegal, thereby invalidating the entire contract.
   d. Unconscionable under the Uniform Commercial Code.

9. In order to establish a common law action for fraud, the aggrieved party must establish that
   a. Although the defendant did **not** in fact know that his statements were false, he made the false statements with a reckless disregard for the truth.
   b. The contract entered into is within the Statute of Frauds.
   c. There was a written misrepresentation of fact by the defendant.
   d. The plaintiff acted as a reasonably prudent businessman in relying upon the misrepresentation.

10. Which of the following is **not** required in order for the plaintiff to prevail in an action for innocent misrepresentation?
   a. That the misrepresentation was intended to induce reliance.
   b. That the misrepresentation amounted to gross negligence.
   c. That the plaintiff acted promptly and offered to restore what was received.
   d. That the plaintiff relied upon the misrepresentation.

11. A common law duty is delegable even though the
   a. Contract provides that the duty is nondelegable.
   b. Duty delegated is the payment of money and the delegatee is **not** of as equal creditworthiness as the delegator.
   c. Delegation will result in a material variance in performance by the delegatee.
   d. Duty to be performed involves personal services.

12. Wilson sold his factory to Glenn. As part of the contract, Glenn assumed the existing mortgage on the property which was held by Security Bank. Regarding the rights and duties of the parties, which of the following is correct?
   a. The promise by Glenn need **not** be in writing to be enforceable by Security.
   b. Security is a creditor beneficiary of Glenn's promise and can recover against him personally in the event of default.
   c. Security is a mere incidental beneficiary since it was **not** a party to the assignment.
   d. Wilson has **no** further liability to Security.

13. Walton owed $10,000 to Grant. Grant assigned his claim against Walton to the Line Finance Company for value on October 15, 1982. On October 25, 1982, Hayes assigned his matured claim for $2,000 against Grant to Walton for value. On October 30, 1982, Line notified Walton of the assignment to them of the $10,000 debt owed by Walton to Grant. Line has demanded payment in full. Insofar as the rights of the various parties are concerned
   a. Walton has the right of a $2,000 set-off against the debt which he owed Grant.
   b. Walton must pay Line in full, but has the right to obtain a $2,000 reimbursement from Grant.
   c. Line is a creditor beneficiary of the debt owed by Walton.
   d. The claimed set-off of the Hayes claim for $2,000 is invalid since it is for an amount which is less than the principal debt.

14. Conrad is seeking to avoid liability on a contract with Fuld. Conrad can avoid liability on the contract if
    a. A third party has agreed to perform his duty and has for a valuable consideration promised to hold Conrad harmless on the obligation to Fuld.
    b. The entire contract has been assigned.
    c. There has been a subsequent unexecuted accord between Fuld and himself.
    d. He has been discharged by a novation.

15. Markum contacted the Variable Loan Company for a business loan. Variable refused to make the loan unless adequate security or an acceptable surety could be provided. Markum asked Duffy, one of his trade customers, to act as surety on the loan. In order to induce Duffy to sign, Markum made certain fraudulent representations and submitted a materially false financial statement. He also promised Duffy favorable treatment if Duffy would agree to act as surety for him. Markum is now insolvent and Variable seeks to hold Duffy liable. Duffy may avoid liability
    a. Since the surety undertaking was void at the inception.
    b. Based upon fraud if Duffy can show Variable was aware of the fraud.
    c. Because Variable had a duty to warn Duffy about Markum's financial condition and did **not** do so.
    d. Because the law of suretyship favors the surety where neither the surety nor the creditor is at fault.

16. An otherwise valid petition for involuntary bankruptcy has been filed against Mohawk Corporation. This will be sufficient to obtain an order for relief against Mohawk provided
    a. Mohawk is generally not paying debts as they become due.
    b. A custodian has been appointed to take charge of substantially all of Mohawk's debts within four months of filing.
    c. The creditor or creditors can establish that Mohawk is bankrupt in the bankruptcy sense.
    d. The majority of creditors join in the filing if there are more than two creditors involved.

17. The Bankruptcy Reform Act of 1978 distinguishes between an exception to discharge of a debt or debts and a denial of discharge. Which of the following types of conduct will result in a denial of discharge?
    a. Obtaining of money or credit by resort to actual fraud.
    b. Fraud or defalcation while acting in a fiduciary capacity.
    c. Transfer by the debtor, with an intent to hinder a creditor, of property within one year before the date of filing of the petition.
    d. Willful and malicious injury by the debtor to another entity or its property.

18. Since the passage of the Bankruptcy Reform Act of 1978, voluntary bankruptcy proceedings have become increasingly popular with debtors. The new law
    a. Increases availability and eases filing.
    b. Increases the amount of property which is exempt.
    c. Reduces the number of creditors necessary for filing.
    d. Accepts solvency in the equity sense as the criterion for determining bankruptcy status.

19. Chapter 11 of the Bankruptcy Reform Act of 1978 deals with reorganizations. This Chapter
    a. Is exclusively available to corporations.
    b. Permits the debtor-in-possession to continue to operate the business in the same manner as a Chapter 11 trustee.
    c. Provides for filing of voluntary petitions but prohibits the filing of involuntary petitions.
    d. Provides separate procedures for corporations with publicly-held securities.

20. Gray and Far are cosureties on a loan of $100,000 made by the Durham Bank to Wilson Fabric, Inc. Gray guaranteed the loan in full and Far guaranteed $50,000 of the loan. Each was aware of the cosurety relationship. Gray received $50,000 of collateral from Wilson as a condition precedent to his serving as cosurety. Wilson has defaulted on the loan. With respect to their ultimate liabilities
    a. Gray is liable for $50,000 but has the exclusive benefit of resort to the collateral to repay his loss.
    b. Gray and Far will each be liable for $50,000.
    c. Since Gray received collateral and Far did not, the relationship is actually one of subsuretyship with Gray being liable for the entire amount.
    d. In the final settlement between the sureties, Far will be liable for a net amount of $16,667.

21. On August 1, 1982, Fields & Boss, CPAs, made a contract with Gil Manufacturing to audit Gil's financial statements for calendar year 1982 and to render an opinion thereon. Gil agreed to an estimated fee of $7,500 for the services. Gil changed its mind and on September 2, 1982, before any services had been performed, notified Fields & Boss that it was repudiating the contract. Which of the following is correct?
    a. The CPA firm may sue for breach of contract immediately and need **not** wait until after performance is due and refused.
    b. The CPA firm is no longer bound on the contract but can **not** sue until after January 1, 1983.
    c. The CPA firm remains bound by the contract until January 1, 1983.
    d. There has been a present breach of the contract.

22. Which of the following transactions does **not** establish Samp as a surety?
   a. Samp says: "Ship goods to my son and I will pay for them."
   b. Samp signs commercial paper as an accommodation indorser for one of his suppliers.
   c. Samp guarantees a debt of a corporation he controls.
   d. Samp sells an office building to Park, and, as a part of the consideration, Park assumes Samp's mortgage on the property.

23. An insolvent debtor made transfers of approximately 70% of inventory to secured creditors in satisfaction of debts. The debts were secured by the inventory. Under the circumstances
   a. Secured creditors must give notice to the other creditors of the debtor.
   b. Transfers in settlement of the security interest are excepted from the bulk sales provisions.
   c. Inventory must be held for one month to enable the creditors to file their claims for any surplus which may arise from its sale.
   d. Failure of the secured creditors to demand and obtain a list of the other creditors of the debtor will invalidate the transfer.

24. Knott obtained a loan of $10,000 from Charles on January 1, 1982, payable on April 15, 1982. At the time of the loan, Beck became a noncompensated surety thereon by written agreement. On April 15, 1982, Knott was unable to pay and wrote to Charles requesting an extension of time. Charles made no reply, but did not take any immediate action to recover. On May 30, 1982, Charles demanded payment from Knott and, failing to collect from him, proceeded against Beck. Based upon the facts stated
   a. Charles was obligated to obtain a judgment against Knott returned unsatisfied before he could collect from Beck.
   b. Beck is released from his surety obligation because Charles granted Knott an extension of time.
   c. Charles may recover against Beck despite the fact Beck was a noncompensated surety.
   d. Beck is released because Charles delayed in proceeding against Knott.

25. Which of the following will release a surety from liability?
   a. Release of the principal debtor from liability with the consent of the surety.
   b. Delegation of the debtor's obligation to another party with the acquiescence of the creditor.
   c. Lack of capacity because the debtor is a minor.
   d. Discharge of the debtor in bankruptcy.

26. Which of the following regarding workers' compensation is correct?
   a. A purpose of workers' compensation is for the employer to assume a definite liability in exchange for the employee giving up his common law rights.
   b. It applies to workers engaged in or affecting interstate commerce only.
   c. It is optional in most jurisdictions.
   d. Once workers' compensation has been adopted by the employer, the amount of damages recoverable is based upon comparative negligence.

27. Which of the following would be the employer's best defense to a claim for workers' compensation by an injured route salesman?
   a. A route salesman is automatically deemed to be an independent contractor, and therefore excluded from workers' compensation coverage.
   b. The salesman was grossly negligent in carrying out the employment.
   c. The salesman's injury was caused primarily by the negligence of an employee.
   d. The salesman's injury did **not** arise out of and in the course of employment.

28. Which of the following employees are exempt from the minimum and maximum hour provisions of the Fair Labor Standards Act?
   a. Children.
   b. Railroad and airline employees.
   c. Members of a union recognized as the bargaining agent by the National Labor Relations Board.
   d. Office workers.

29. Under the Fair Labor Standards Act the Secretary of Labor does **not** have the power to
   a. Issue subpoenas compelling attendance by a witness and the production of records by an employer.
   b. Conduct investigations regarding practices subject to the Act.
   c. Issue a wage order which requires an employer to pay wages found to be due and owing under the Act.
   d. Issue injunctions to restrain obvious violations of the Act.

30. Under the Foreign Corrupt Practices Act, an action may be brought which seeks
   a. Treble damages by a private party.
   b. Injunctive relief by a private party.
   c. Criminal sanctions against both the corporation and its officers by the Department of Justice.
   d. Damages and injunctive relief by the Securities and Exchange Commission.

31. Which of the following securities or security transactions is automatically exempt under the Securities Act of 1933 from the Act's registration requirements?
   a. An offering of $3,000,000 or less of stock to 25 or fewer persons.
   b. A $10 million offering of first mortgage bonds to the public.
   c. An exchange by a corporation of its own securities with existing shareholders without payment of brokerage commissions.
   d. Sale by a director of her shares of stock providing that she owns less than 10% of the corporation's stock and that the sale is on a registered stock exchange.

32. Which of the following is required under the Securities Exchange Act of 1934 or the SEC's reporting requirements issued pursuant thereto?
   a. Current reporting by issuers of registered securities of certain specified corporate and financial events within ten days after the close of the month in which they occur.
   b. Quarterly audited financial reports and statements by those corporations listed on a national exchange.
   c. Reporting by issuers of securities which are traded over-the-counter, but only if the securities are actively traded.
   d. Annual filing of audited financial reports by all corporations engaged in interstate commerce.

33. Insofar as the Securities Act of 1933 and the Securities Exchange Act of 1934 are concerned with fraud
   a. The Acts are identical with respect to proscribing fraudulent transactions.
   b. The antifraud provisions are contained exclusively in the 1934 Act.
   c. The 1933 Act does not require proof of scienter in all circumstances whereas the 1934 Act does.
   d. Only the 1933 Act contains criminal sanctions against those found to be guilty of fraud.

34. Downtown Disco, Inc., engaged Charleston as club manager in a written agreement providing for a $20,000 salary, plus 2% of gross revenues, and exclusive management authority including entertainment bookings. The agreement is irrevocable by Downtown for three years but terminable by Charleston upon one month's written notice. The Downtown-Charleston arrangement is
   a. An agency coupled with an interest.
   b. A partnership between Downtown and Charleston.
   c. Terminable at any time by Downtown despite the three-year irrevocability clause.
   d. Enforceable by Charleston by an action for specific performance.

Items 35 through 37 all concern instruments which Alex & Co. has in its possession:

35.

September 2, 1982

I, Henry Hardy, do hereby acknowledge my debt to Walker Corporation arising out of my purchase of soybeans and promise to pay to Walker or to its order, SIX HUNDRED DOLLARS, thirty days after presentment of this instrument to me at my principal place of business.

Henry Hardy

Henry Hardy

Re: $600.00 - Soybean purchase

The above instrument is
   a. Nonnegotiable.
   b. A negotiable promissory note.
   c. A trade acceptance.
   d. A negotiable bill of lading.

36.

No. 003

Nov. 1, 1982 62-105/251

Pay to the order of *Alex & Co.* $1,000.00

One Thousand and 00/100 Dollars

Ten days after presentment

Security Trust Company
Austin, Texas

Memo: For purchases of securities

Herbert Stein

Herbert Stein

The above instrument is
   a. Nonnegotiable.
   b. A draft.
   c. A trade acceptance.
   d. A check.

37.

October 5, 1982

To: Henry Futterman Suppliers
281 Cascade Boulevard
Spokane, Washington 99208

$950.00

Pay to the order of Alex & Co.
Nine hundred fifty and 00/100 dollars
one month after acceptance.

Alex & Co.

By Charles Alex
Managing Partner

Alex & Co.
264 Liberty Avenue
Philadelphia, Pa. 19117

Accepted by: Laura Futterman, Treasurer
Henry Futterman Suppliers

Date: October 15, 1982

The above instrument is
a. Nonnegotiable since the payee is also the drawer.
b. A time promissory note.
c. A trade acceptance which imposes primary liability upon Henry Futterman Suppliers after acceptance.
d. A negotiable investment security under the Uniform Commercial Code.

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38. Kirk made a check payable to Haskin's order for a debt she owed on open account. Haskin negotiated the check by a blank indorsement to Carlson who deposited it in his checking account. The bank returned the check with the notation that payment was refused due to insufficient funds. Kirk is insolvent. Under the circumstances
a. Kirk has a real defense assertable against all parties including Carlson, a holder in due course.
b. If Kirk files for bankruptcy, Haskin or Carlson could successfully assert that there had been an assignment of whatever funds were in Kirk's checking account.
c. If there is a proper presentment, and notice is properly given by Carlson to Haskin, Carlson may recover the amount of the check from Haskin.
d. Haskin or Carlson can correctly assert the standing of a secured creditor.

39. An instrument complies with the requirements for negotiability contained in the Commercial Paper Article of the Uniform Commercial Code. The instrument contains language expressly acknowledging the receipt of $10,000 by the First Bank of Grand Rapids and an agreement to repay principal with interest at 15% one year from date. This instrument is
a. Nonnegotiable because of the additional language.
b. A negotiable certificate of deposit.
c. A banker's draft.
d. A banker's acceptance.

40. Below is a note which your client, Robinson Real Estate, Inc., obtained from Grant in connection with Grant's purchase of a homesite located in Bangor, Maine. The note was given for the balance due on the purchase and was secured by a first mortgage on the homesite.

$17,000.00 — Bangor, Maine
November 1, 1982

For value received, five years after date, I promise to pay to the order of Robinson Real Estate, Inc., SEVENTEEN THOUSAND and 00/100 DOLLARS with interest at 15% compounded annually until fully paid. This instrument arises out of the sale of land located in Maine and the law of Maine is to be applied to any question which may arise. It is secured by a first mortgage on the land conveyed. It is further agreed that:

1. Purchaser will pay the costs of collection including attorney's fees upon default.
2. Purchaser may repay the amount outstanding on any anniversary date of this note.
3. This note is subject to such implied conditions as are applicable to such notes.

Robert Grant
Robert Grant

This note is a
a. Nonnegotiable promissory note since it is secured by a first mortgage.
b. Nonnegotiable promissory note since it permits prepayment and requires the maker's payment of the costs of collection and attorney's fees.
c. Negotiable promissory note.
d. Negotiable investment security under the Uniform Commercial Code.

41. Ash Company has in its possession the following note:

> October 15, 1982
>
> I, Joseph Gorman, promise to pay or deliver to Harold Smalley or to his order ONE THOUSAND DOLLARS ($1,000) or at his option to deliver an amount of stock in the Sunrise Corporation which, on the due date of this instrument, is worth not less than ONE THOUSAND DOLLARS ($1,000). This note is due and payable on the 1st of November, 1982.
>
> Joseph Gorman
>
> Joseph Gorman

This note is

a. Not commercial paper, but instead a negotiable investment security.
b. A negotiable promissory note since it is payable to Smalley's order and contains an unconditional promise to pay $1,000 if the holder so elects.
c. Nonnegotiable since it gives Smalley the option to take stock instead of cash.
d. Nontransferable.

42. The following three indorsements appear on the back of a negotiable promissory note made payable to Harold Dawson. The note is in the possession of Maxim Company.

> Pay to James Edwards
> *Harold Dawson*
>
> Without Recourse
> *James Edwards*
>
> *Gilbert Olsen*

The instrument has been dishonored after due presentment by Maxim. Proper notice of dishonor has been given to all parties. Which of the following is correct?

a. James Edwards' signature on the instrument was **not** necessary.
b. James Edwards has effectively negated all warranty liability to any subsequent party except Gilbert Olsen.
c. James Edwards has neither contractual nor warranty liability as a result of his indorsing without recourse.
d. Gilbert Olsen's signature was **not** necessary to effectively negotiate the instrument to Maxim.

43. Dodger fraudulently induced Tell to issue a check to his order for $900 in payment for some nearly worthless securities. Dodger took the check and artfully raised the amount from $900 to $1,900. He promptly negotiated the check to Bay who took in good faith and for value. Tell, upon learning of the fraud, issued a stop order to its bank. Which of the following is correct?

a. Dodger has a real defense which will prevent any of the parties from collecting anything.
b. The stop order was ineffective against Bay since it was issued after the negotiation to Bay.
c. Bay as a holder in due course will prevail against Tell but only to the extent of $900.
d. Had there been no raising of the amount by Dodger, the bank would be obligated to pay Bay despite the stop order.

44. Lee Motors sold an oral option to Hall, Inc., for $50. The option was to purchase any late model used automobiles received by Lee as trade-ins on new cars for the next 100 days. Hall paid the $50 and promptly sent Lee a signed memorandum which correctly described the agreement and its terms. Lee did not respond until after 30 days had elapsed and it had discovered it had made a very bad bargain. Therefore, it notified Hall that it would no longer perform under the terms of the option, which it alleged was invalid, and it enclosed a check for $50 to Hall's order. Which of the following is correct?

a. The oral option is invalid for lack of consideration.
b. The Statute of Frauds can be validly asserted by Lee to avoid liability.
c. Lee has entered into a valid contract with Hall.
d. Options for a duration of more than three months are unenforceable.

45. Stand Glue Corp. offered to sell Macal, Inc., all of the glue it would need in the manufacture of its furniture for one year at the rate of $25 per barrel, F.O.B. seller's city. Macal accepted Stand's offer. Four months later, due to inflation, Stand wrote to Macal advising Macal that Stand could no longer supply the glue at $25 per barrel, but offering to fulfill the contract at $28 per barrel instead. Macal, in need of the glue, sent Stand a letter agreeing to pay the price increase. Macal is

a. Legally obligated to pay only $25 per barrel under the contract with Stand.
b. Legally obligated to pay $28 per barrel under the contract with Stand.
c. **Not** legally obligated to purchase any glue henceforth from Stand since Stand has breached the contract.
d. Legally obligated to pay $28 per barrel due to the fact inflation represents an unforeseen hardship.

46. A negotiable bill of lading is duly negotiated even though
   a. The negotiation is **not** in the ordinary course of business.
   b. It is received by the transferee in payment of a money obligation.
   c. It is **not** negotiable upon issuance, but is subsequently indorsed in blank and transferred.
   d. It is initially payable to the order of a named person, who signs in blank and delivers it to the transferee.

47. Webster purchased a drill press for $475 from Martinson Hardware, Inc. The press has proved to be defective and Webster wishes to rescind the purchase based upon a breach of implied warranty. Which of the following will preclude Webster's recovery from Martinson?
   a. The press sold to Webster was a demonstration model and sold at a substantial discount; hence, Webster received no implied warranties.
   b. Webster examined the press carefully, but as regards the defects, they were hidden defects which a reasonable examination would **not** have revealed.
   c. Martinson informed Webster that they were closing out the model at a loss due to certain deficiencies and that it was sold "with all faults."
   d. The fact that it was the negligence of the manufacturer which caused the trouble and that the defect could **not** have been discovered by Martinson without actually taking the press apart.

48. Falcon, by telegram to Southern Wool, Inc., ordered 30 bolts of cloth, first quality, 60% wool and 40% dacron. The shipping terms were F.O.B. Falcon's factory in Norwalk, Connecticut. Southern accepted the order and packed the bolts of cloth for shipment. In the process it discovered that one half of the bolts packed had been commingled with cloth which was 50% wool and 50% dacron. Since Southern did not have any additional 60% wool cloth, it decided to send the shipment to Falcon as an accommodation. The goods were shipped and later the same day Southern wired Falcon its apology informing Falcon of the facts and indicating that the 15 bolts of 50% wool would be priced at $15 a bolt less. The carrier delivering the goods was hijacked on the way to Norwalk. Under the circumstances, who bears the risk of loss?
   a. Southern, since they shipped goods which failed to conform to the contract.
   b. Falcon, since the shipping terms were F.O.B. Falcon's place of business.
   c. Southern, because the order was **not** a signed writing.
   d. Falcon, since Falcon has title to the goods.

49. Filmore purchased a Miracle color television set from Allison Appliances, an authorized dealer, for $499. The written contract contained the usual one-year warranty as to parts and labor as long as the set was returned to the manufacturer or one of its authorized dealers. The contract also contained an effective disclaimer of any express warranty protection, other than that which was included in the contract. It further provided that the contract represented the entire agreement and understanding of the parties. Filmore claims that during the bargaining process Surry, Allison's agent, orally promised to service the set at Filmore's residence if anything went wrong within the year. Allison has offered to repair the set if it is brought to the service department, but denies any liability under the alleged oral express agreement. Which of the following would be the best defense for Allison to rely upon in the event Filmore sues?
   a. The Statute of Frauds.
   b. The parol evidence rule.
   c. The fact that all warranty protection was disclaimed other than the express warranty contained in the contract.
   d. The fact that Surry, Allison's agent, did **not** have express authority to make such a promise.

50. Sanders Hardware Company received an order for $900 of assorted hardware from Richards & Company. The shipping terms were F.O.B. Lester Freight Line, seller's place of business, 2/10, net/30. Sanders packed and crated the hardware for shipment and it was loaded upon Lester's truck. While the goods were in transit to Richards, Sanders learned that Richards was insolvent in the equity sense (unable to pay its debts in the ordinary course of business). Sanders promptly wired Lester's office in Denver, Colorado, and instructed them to stop shipment of the goods to Richards and to store them until further instructions. Lester complied with these instructions. Regarding the rights, duties, and liabilities of the parties, which of the following is correct?
   a. Sanders' stoppage in transit was improper if Richards' assets exceeded its liabilities.
   b. Richards is entitled to the hardware if it pays cash.
   c. Once Sanders correctly learned of Richards' insolvency, it had no further duty or obligation to Richards.
   d. The fact that Richards became insolvent in no way affects the rights, duties, and obligations of the parties.

51. A holder in due course will take an instrument free from which of the following defenses?
   a. Discharge in insolvency proceedings.
   b. Infancy of the maker or drawer.
   c. Claims of ownership on the part of other persons.
   d. The forged signature of the maker or drawer.

52. Lombard, Inc., manufactures exclusive designer apparel. It sells through franchised clothing stores on consignment, retaining a security interest in the goods. Gifford is one of Lombard's franchisees pursuant to a detailed contract signed by both Lombard and Gifford. In order for the security interest to be valid against Gifford with respect to the designer apparel in Gifford's possession, Lombard

a. Must retain title to the goods.
b. Does not have to do anything further.
c. Must file a financing statement.
d. Must perfect its security interest against Gifford's creditors.

53. Hathaway purchased from Rustic Hardware a new lathe for his home workshop for cash. Two weeks later, Hathaway was called by the Shuster Loan Company. Shuster explained to Hathaway that it had been financing Rustic's purchases from the manufacturers and that to protect its interest it had obtained a perfected security interest in Rustic's entire inventory of hardware and power tools, including the lathe which Hathaway bought. Shuster further explained that Rustic had defaulted on a payment due to Shuster, and Shuster intended to assert its security interest in the lathe and repossess it unless Hathaway was willing to make payment of $220 for a release of Shuster's security interest. If Hathaway refuses to make the payment, which of the following is correct?

a. Shuster's security interest in the lathe in question is invalid against all parties unless its filing specifically described and designated the particular lathe Hathaway purchased.
b. Hathaway must pay the $220 or the lathe can be validly repossessed and sold to satisfy the amount Rustic owes Shuster and any excess paid to Hathaway.
c. Hathaway will **not** take free of Shuster's security interest if he was aware of said interest at the time he purchased the lathe.
d. Even if Hathaway had both actual notice and constructive notice via recordation of Shuster's interest, he will prevail if Shuster seeks to repossess the lathe.

54. Two Uniform Commercial Code concepts relating to secured transactions are "attachment" and "perfection." Which of the following is correct in connection with the similarities and differences between these two concepts?

a. They are mutually exclusive and wholly independent of each other.
b. Attachment relates primarily to the rights against the debtor and perfection relates primarily to the rights against third parties.
c. Satisfaction of one automatically satisfies the other.
d. It is **not** possible to have a simultaneous attachment and perfection.

55. Tawney Manufacturing approached Worldwide Lenders for a loan of $50,000 to purchase vital components it used in its manufacturing process. Worldwide decided to grant the loan but only if Tawney would agree to a field warehousing arrangement. Pursuant to their understanding, Worldwide paid for the purchase of the components, took a negotiable bill of lading for them, and surrendered the bill of lading in exchange for negotiable warehouse receipts issued by the bonded warehouse company that had established a field warehouse in Tawney's storage facility. Worldwide did not file a financing statement. Under the circumstances, Worldwide

a. Has a security interest in the goods which has attached and is perfected.
b. Does **not** have a security interest which has attached since Tawney has not signed a security agreement.
c. Must file an executed financing statement in order to perfect its security interest.
d. Must **not** relinquish control over any of the components to Tawney for whatever purpose, unless it is paid in cash for those released.

56. On October 1, 1982, Winslow Corporation obtained a loan commitment of $250,000 from Liberty National Bank. Liberty filed a financing statement on October 2, 1982. On October 5, 1982, the $250,000 loan was consummated and Winslow signed a security agreement granting the bank a security interest in inventory, accounts receivable, and proceeds from the sale of the inventory and collection of the accounts receivable. Liberty's security interest was perfected

a. On October 1.
b. On October 2.
c. On October 5.
d. By attachment.

57. Thrush, a wholesaler of television sets, contracted to sell 100 sets to Kelly, a retailer. Kelly signed a security agreement with the 100 sets as collateral. The security agreement provided that Thrush's security interest extended to the inventory, to any proceeds therefrom, and to the after-acquired inventory of Kelly. Thrush filed his security interest centrally. Later, Kelly sold one of the sets to Haynes who purchased with knowledge of Thrush's perfected security interest. Haynes gave a note for the purchase price and signed a security agreement using the set as collateral. Kelly is now in default. Thrush can

a. Not repossess the set from Haynes, but is entitled to any payments Haynes makes to Kelly on his note.
b. Repossess the set from Haynes as he has a purchase money security interest.
c. Repossess the set as his perfection is first, and first in time is first in right.
d. Repossess the set in Haynes' possession because Haynes knew of Thrush's perfected security interest at the time of purchase.

58. Clearview Manufacturing, Inc., sells golf equipment to wholesale distributors, who sell to retailers, who in turn sell to golfers. In most instances, the golf equipment is sold on credit with a security interest in the goods taken by each of the respective sellers. With respect to the above described transactions

a. The only parties who qualify as purchase money secured parties are the retailers.
b. The security interests of all of the parties remain valid even against good faith purchasers despite the fact that resale was contemplated.
c. Except for the retailers, all of the sellers must file or have possession of the goods in order to perfect their security interests.
d. The golf equipment is inventory in the hands of all the parties involved.

59. Nick owns 200 shares of stock of Sylvester Manufacturing Company. Sylvester is listed on a national stock exchange and has in excess of one million shares outstanding. Nick claims that Abner, a Sylvester director, has purchased and sold shares in violation of the insider trading provisions of the Securities Exchange Act of 1934. Nick has threatened legal action. Which of the following is correct?

a. Abner will have a valid defense if he can show he did **not** have any insider information which influenced his purchases or sales.
b. Since Nick's stock ownership is less than 1%, his only recourse is to file a complaint with the SEC or obtain a sufficient number of other shareholders to join him so that the 1% requirement is met.
c. In order to prevail, Nick must sue for and on behalf of the corporation and establish that the transactions in question occurred within less than six months of each other and at a profit to Abner.
d. Nick can sue Abner personally, but his recovery will be limited to his proportionate share of Abner's profits plus legal expenses.

60. Drummond broke into the Apex Drug Store and took all of the cash and checks which were in the cash register. The checks reflect payments made to Apex for goods sold. Drummond disposed of the checks and has disappeared. Apex is worried about its ability to recover the checks from those now in possession of them. Which of the following is correct?

a. Apex will prevail as long as its signature was necessary to negotiate the checks in question.
b. Since there was no valid transfer by Apex to Drummond, subsequent parties have no better rights than the thief had.
c. Apex will prevail only if the checks were payable to cash.
d. Apex will not prevail on any of the checks since it was the only party that could have prevented the theft.

Number 2 (Estimated time —— 15 to 20 minutes)

The following information applies to both Parts a and b.

James Danforth, CPA, audited the financial statements of the Blair Corporation for the year ended December 31, 1981. Danforth rendered an unqualified opinion on February 6, 1982. The financial statements were incorporated into Form 10-K and filed with the Securities and Exchange Commission. Blair's financial statements included as an asset a previously sold certificate of deposit (CD) in the amount of $250,000. Blair had purchased the CD on December 29, 1981, and sold it on December 30, 1981, to a third party who paid Blair that day. Blair did not deliver the CD to the buyer until January 8, 1982. Blair deliberately recorded the sale as an increase in cash and other revenue thereby significantly overstating working capital, stockholders' equity, and net income. Danforth confirmed Blair's purchase of the CD with the seller and physically observed the CD on January 5, 1982.

Part a. Assume that on January 18, 1982, while auditing other revenue, Danforth discovered that the CD had been sold. Further assume that Danforth agreed that in exchange for an additional audit fee of $20,000, he would render an unqualified opinion on Blair's financial statements (including the previously sold CD).

Required: Answer the following, setting forth reasons for any conclusions stated.

1. The SEC charges Danforth with criminal violations of the Securities Exchange Act of 1934. Will the SEC prevail? Include in your discussion what the SEC must establish in this action.
2. Assume the SEC discovers and makes immediate public disclosure of Blair's action with the result that no one relies to his detriment upon the audit report and financial statements. Under these circumstances, will the SEC prevail in its criminal action against Danforth?

Part b. Assume that Danforth performed his audit in accordance with generally accepted auditing standards (GAAS) and exercised due professional care, but did not discover Blair's sale of the CD. Two weeks after issuing the unqualified opinion, Danforth discovered that the CD had been sold. The day following this discovery, at Blair's request, Danforth delivered a copy of the audit report, along with the financial statements, to a bank which in reliance thereon made a loan to Blair that ultimately proved uncollectible. Danforth did not advise the bank of his discovery.

Required: Answer the following, setting forth reasons for any conclusions stated.

If the bank sues Danforth for the losses it sustains in connection with the loan, will it prevail?

Number 3 (Estimated time —— 15 to 20 minutes)

Part a. William Harrelson is president of the Billings Corporation, a medium-size manufacturer of yogurt. While serving as president, Harrelson learns of an interesting new yogurt product loaded with vitamin additives and with a potentially huge market. He immediately forms another corporation, the Wexler Corporation, to produce and market the new product. In his zeal, however, Harrelson overextends his personal credit and utilizes Billings' credit, along with its plant and employees, as needed, to produce the new product. The new product becomes a big success. As a result, Harrelson's Wexler stock is presently worth millions of dollars.

Required: Answer the following, setting forth reasons for any conclusions stated.

Billings' shareholders contend that Harrelson's actions are improper and seek a remedy against him. Will they succeed and what remedies are available to them?

Part b. While auditing the financial statements of Graham, Phillips, Killian, and Henderson, a real estate partnership, for the year ended December 31, 1981, a CPA uncovers a number of unrelated events which warrant closer analysis:

- Graham died and left her partnership interest to her spouse.
- Phillips owned some real estate prior to the formation of the partnership but never formally transferred legal title to the partnership. The real estate has been used for partnership business since the partnership began its existence, and the partnership has paid all taxes associated with the real estate.
- Killian owes a considerable sum of money to a creditor, Jamison. Jamison has a judgment against Killian and has begun a foreclosure action against certain land owned by the partnership in order to satisfy his claim against Killian.
- Henderson sold some of the partnership real estate for value remitted to the partnership without the approval of the other partners. This sale exceeded Henderson's actual authority but appeared to be a customary sale in the ordinary course of business.

Required: Answer the following, setting forth reasons for any conclusions stated.

1. Graham's spouse is presently seeking to exercise his spousal rights to obtain certain specific property owned by the partnership. Discuss the likely outcome of this matter.
2. Regarding the real estate that is legally in Phillips' name, can the partnership properly reflect this as an asset in the partnership's balance sheet?
3. Will Jamison succeed in his land foreclosure action?
4. If the partnership now wishes to rescind the sale of the real estate by Henderson, can it lawfully do so?

Number 4 (Estimated time —— 15 to 20 minutes)

Part a. Spencer, Inc., manufactures quality stereo systems and parts. It markets these items through franchised dealers who purchase the goods, take title to them, and are granted the exclusive right to sell the product in clearly defined geographic areas. The dealers in turn are obligated not to sell in any other geographic area. The following is typical of such a territorial clause:

> Dealer is hereby granted the exclusive right as hereinafter described to sell, during the term of this agreement, in the territory described below, Spencer products purchased from the company hereunder.
> *(Assume geographic description of territory paragraph is included.)*
> Dealer agrees to develop the aforementioned territory to the satisfaction of Spencer.
> Dealer further agrees not to sell, nor to permit, nor to authorize any other party to sell, Spencer products in any other franchised territory.

The franchised dealers are not obligated to sell only Spencer's products, but are free to handle competing lines if they wish to do so.

Blaine Hi-Fi, Inc., applied for a franchised dealership. Spencer refused to permit Blaine to sell in the territory already granted to another dealer. Blaine claims that Spencer's franchised dealerships are illegal per se as an unreasonable restraint of trade.

Required: Answer the following, setting forth reasons for any conclusions stated.

Are the above described franchised dealership arrangements illegal per se under the antitrust laws?

Part b. Powell Corporation, which owns 5% of the stock of Baron, Inc., approached the board of directors and several of the principal shareholders of Baron to see if they were willing to sell to Powell their effective controlling interest. Baron is listed on the American Stock Exchange and its management either owns or has the unquestioned support of approximately 37% of the shares outstanding. Baron's board and the shareholders who were contacted rejected Powell's overtures. Powell is now considering waging a proxy fight to obtain effective control of Baron.

Required: Answer the following, setting forth reasons for any conclusions stated.

1. Can Baron lawfully refuse to give Powell access to the list of shareholders?
2. What rights does Powell have under the Securities Exchange Act of 1934 to have its proxy materials distributed to shareholders?
3. What major requirements under the Securities Exchange Act of 1934 must be met by both sides in a proxy fight?

Number 5 (Estimated time —— 15 to 20 minutes)

Part a. While auditing the financial statements of Jackson Corporation for the year ended December 31, 1981, Harvey Draper, CPA, desired to verify the balance in the insurance claims receivable account. Draper obtained the following information:

- On November 4, 1981, Jackson's Parksdale plant was damaged by fire. The fire caused $200,000 damage to the plant, which was purchased in 1970 for $600,000. When the plant was purchased, Jackson obtained a loan secured by a mortgage from Second National Bank of Parksdale. At the time of the fire the loan balance, including accrued interest, was $106,000. The plant was insured against fire with Eagle Insurance Company. The policy contained a "standard mortgagee" clause and an 80% coinsurance clause. The face value of the policy was $600,000 and the value of the plant was $1,000,000 at the time of the fire.

- On December 10, 1981, Jackson's Yuma warehouse was totally destroyed by fire. The warehouse was acquired in 1960 for $300,000. At the time of the fire, the warehouse was unencumbered by any mortgage; it was insured against fire with Eagle for $300,000; and it had a value of $500,000. The policy contained an 80% coinsurance clause.

- On December 26, 1981, Jackson's Rye City garage was damaged by fire. At the time of the fire, the garage had a value of $250,000 and was unencumbered by any mortgage. The fire caused $60,000 damage to the garage, which was constructed in 1965 at a cost of $50,000. In 1975 Jackson expanded the capacity of the garage at an additional cost of $50,000. When the garage was constructed in 1965, Jackson insured the garage against fire for $50,000 with Eagle, and this policy was still in force on the date of the fire. When the garage was expanded in 1975, Jackson obtained $100,000 of additional fire insurance coverage from Queen Insurance Company. Each policy contains an 80% coinsurance clause and a standard pro-rata clause.

Required: Answer the following, setting forth reasons for any conclusions stated.

1. How much of the fire loss relating to the Parksdale plant will be recovered from Eagle?
2. How will such recovery be distributed between Second National and Jackson?
3. How much of the fire loss relating to the Yuma warehouse will be recovered from Eagle?
4. How much of the fire loss relating to the Rye City garage will be recovered from the insurance companies?
5. What portion of the amount recoverable in connection with the Rye City garage loss will Queen be obligated to pay?

Part b. Darby Corporation, a manufacturer of power tools, leased a building for 20 years from Grayson Corporation commencing January 1, 1981. During January 1981, Darby affixed to the building a central air conditioning system and certain heavy manufacturing machinery, each with an estimated useful life of 30 years.

While auditing Darby's financial statements for the year ended December 31, 1981, the auditor noted that Darby was depreciating the air conditioning equipment and machinery, for financial accounting purposes, over their estimated useful lives of 30 years. In reading the lease, the auditor further noted that there was no provision with respect to the removal by the lessee of the central air conditioning system or machinery upon expiration of the lease. To verify that the appropriate estimated useful lives are being utilized for recording depreciation, the auditor is interested in establishing the rightful ownership of these assets upon the expiration of the lease. The auditor knows that in order to determine ownership of the assets at the expiration of the lease, one must first determine whether the assets would be considered personalty or realty.

Required: Answer the following, setting forth reasons for any conclusions stated.

What major factors would likely be considered by a court in determining whether the air conditioning system and the machinery are to be regarded as personalty or realty, and what would be the likely determination with respect to each?

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN ACCOUNTING THEORY

(Theory of Accounts)

November 5, 1982; 1:30 to 5:00 P.M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	Estimated Minutes Minimum	Estimated Minutes Maximum
No. 1	90	110
No. 2	15	25
No. 3	15	25
No. 4	15	25
No. 5	15	25
Total	150	210

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers.

3. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 90 to 110 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of issues in accounting.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

99. The financial statement which summarizes the financial position of a company is the
    a. Income statement.
    b. Balance sheet.
    c. Statement of changes in financial position.
    d. Retained earnings statement.

Answer Sheet

99. (a) ● (c) (d)

Items to be Answered

1. Under Statement of Financial Accounting Concepts No. 2, the ability through consensus among measurers to ensure that information represents what it purports to represent is an example of the concept of
    a. Relevance.
    b. Verifiability.
    c. Comparability.
    d. Feedback value.

2. How would the retained earnings of a subsidiary acquired in a business combination usually be treated in a consolidated balance sheet prepared immediately after the acquisition?
    a. Excluded for both a purchase and a pooling of interests.
    b. Excluded for a pooling of interests but included for a purchase.
    c. Included for both a purchase and a pooling of interests.
    d. Included for a pooling of interests but excluded for a purchase.

3. In accordance with FASB Statement No. 33, the Consumer Price Index for All Urban Consumers is used to compute information on a
    a. Historical cost basis.
    b. Current cost basis.
    c. Constant dollar basis.
    d. Nominal dollar basis.

4. Consolidated financial statements are typically prepared when one company has
    a. Accounted for its investment in another company by the equity method.
    b. Accounted for its investment in another company by the cost method.
    c. Significant influence over the operating and financial policies of another company.
    d. The controlling financial interest in another company.

5. When an investor uses the cost method to account for investments in common stock, cash dividends received by the investor from the investee should normally be recorded as
    a. Dividend income.
    b. An addition to the investor's share of the investee's profit.
    c. A deduction from the investor's share of the investee's profit.
    d. A deduction from the investment account.

6. The LIFO inventory cost flow method may be applied to which of the following inventory systems?

	Periodic	*Perpetual*
a.	No	No
b.	No	Yes
c.	Yes	Yes
d.	Yes	No

7. Under the retail inventory method, freight-in would be included in the calculation of the goods available for sale for which of the following?

	Cost	*Retail*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

8. When a company replaces an old asphalt roof on its plant with a new fiberglass insulated roof, which of the following types of expenditure occurs?
    a. Ordinary repair and maintenance.
    b. Addition.
    c. Rearrangement.
    d. Betterment.

9. The excess of the subscription price over the par value of nonredeemable preferred stock subscribed should be recorded as
    a. A liability.
    b. Additional paid-in capital.
    c. Retained earnings.
    d. Revenue.

10. In a lease that is recorded as a sales-type lease by the lessor, the difference between the gross investment in the lease and the sum of the present values of the components of the gross investment should be recognized as income
    a. In full at the lease's expiration.
    b. In full at the lease's inception.
    c. Over the period of the lease using the interest method of amortization.
    d. Over the period of the lease using the straight-line method of amortization.

11. An estimated loss from a loss contingency that is probable and for which the amount of the loss can be reasonably estimated should
    a. Not be accrued but should be disclosed in the notes to the financial statements.
    b. Be accrued by debiting an appropriated retained earnings account and crediting a liability account or an asset account.
    c. Be accrued by debiting an expense account and crediting an appropriated retained earnings account.
    d. Be accrued by debiting an expense account and crediting a liability account or an asset account.

12. A fixed asset with a five-year estimated useful life is sold during the second year. How would the use of the straight-line method of depreciation instead of the double-declining-balance method of depreciation affect the amount of gain or loss on the sale of the fixed asset?

	Gain	*Loss*
a.	No effect	No effect
b.	No effect	Increase
c.	Decrease	Increase
d.	Increase	Decrease

13. The correction of an error in the financial statements of a prior period should be reflected, net of applicable income taxes, in the current
    a. Income statement after income from continuing operations and before extraordinary items.
    b. Income statement after income from continuing operations and after extraordinary items.
    c. Retained earnings statement as an adjustment of the opening balance.
    d. Retained earnings statement after net income but before dividends.

14. Which of the following could require interperiod tax allocation?
    a. Premiums paid on officers' life insurance.
    b. Unearned service contract revenue.
    c. Interest received on municipal obligations.
    d. Dividends received exclusion.

15. A company issued rights to its existing shareholders to purchase 5,000 unissued shares of common stock with a par value of $10 per share for $25 per share. Additional paid-in capital would be recorded when the rights
    a. Expire.
    b. Are exercised.
    c. Become exercisable.
    d. Are issued.

16. A company with a substantial deficit undertakes a quasi-reorganization. Certain assets will be written down to their present fair market value. Liabilities will remain the same. How would the entries to record the quasi-reorganization affect each of the following?

	Contributed capital	*Retained earnings*
a.	Increase	Decrease
b.	Decrease	No effect
c.	Decrease	Increase
d.	No effect	Increase

17. The excess of the fair value of leased property at the inception of the lease over its cost or carrying amount should be classified by the lessor as
    a. Unearned income from a sales-type lease.
    b. Unearned income from a direct-financing lease.
    c. Manufacturer's or dealer's profit from a sales-type lease.
    d. Manufacturer's or dealer's profit from a direct-financing lease.

18. The pension expense accrued by a company will be increased by interest equivalents when
    a. The plan is fully vested.
    b. The plan is fully funded.
    c. Amounts funded are less than pension cost accrued.
    d. Amounts funded are greater than pension cost accrued.

19. Ten thousand (10,000) shares of common stock with a par value of $20 per share were initially issued at $25 per share. Subsequently, two thousand (2,000) of these shares were purchased as treasury stock at $30 per share. Assuming that the par value method of accounting for treasury stock transactions is used, what is the effect of the purchase of the treasury stock on each of the following?

	Additional paid-in capital	*Retained earnings*
a.	Decrease	Increase
b.	Decrease	Decrease
c.	Increase	Decrease
d.	Increase	No effect

20. Equal monthly rental payments for a particular lease should be charged to rental expense by the lessee for which of the following?

	Capital lease	*Operating lease*
a.	Yes	No
b.	Yes	Yes
c.	No	No
d.	No	Yes

21. In a periodic inventory system which uses the weighted average cost flow method, the beginning inventory is the
   a. Net purchases minus the cost of goods sold.
   b. Net purchases minus the ending inventory.
   c. Total goods available for sale minus the net purchases.
   d. Total goods available for sale minus the cost of goods sold.

22. For a compensatory stock option plan for which the date of grant and the measurement date are different, compensation cost should be recognized in the income statement
   a. At the later of grant or measurement date.
   b. At the exercise date.
   c. Of each period in which the services are rendered.
   d. At the adoption date of the plan.

23. A loss should be presented separately as a component of income from continuing operations when it is unusual in nature and which of the following?

	Material in amount	*Infrequent in occurrence*
a.	No	Yes
b.	No	No
c.	Yes	No
d.	Yes	Yes

24. In determining earnings per share, interest expense, net of applicable income taxes, on convertible debt which is both a common stock equivalent and dilutive should be
   a. Added back to net income for primary earnings per share, and ignored for fully diluted earnings per share.
   b. Added back to net income for both primary earnings per share and fully diluted earnings per share.
   c. Deducted from net income for primary earnings per share, and ignored for fully diluted earnings per share.
   d. Deducted from net income for both primary earnings per share and fully diluted earnings per share.

25. An activity that would be expensed currently as research and development costs is the
   a. Testing in search for or evaluation of product or process alternatives.
   b. Adaptation of an existing capability to a particular requirement or customer's need as a part of continuing commercial activity.
   c. Legal work in connection with patent applications or litigation, and the sale or licensing of patents.
   d. Engineering follow-through in an early phase of commercial production.

26. Bad debt expense on long-term receivables should be presented in a statement of changes in financial position as a (an)
   a. Use of funds.
   b. Source and a use of funds.
   c. Deduction from income from continuing operations.
   d. Addition to income from continuing operations.

27. Which of the following should be presented in a statement of changes in financial position only because of the all-financial-resources concept?
   a. Conversion of preferred stock to common stock.
   b. Purchase of treasury stock.
   c. Sale of common stock.
   d. Declaration of cash dividend.

28. A change in the salvage value of an asset depreciated on a straight-line basis and arising because additional information has been obtained is
   a. An accounting change that should be reported in the period of change and future periods if the change affects both.
   b. An accounting change that should be reported by restating the financial statements of all prior periods presented.
   c. A correction of an error.
   d. Not an accounting change.

29. Under Statement of Financial Accounting Concepts No. 2, which of the following is an ingredient of the primary quality of relevance?
   a. Predictive value.
   b. Materiality.
   c. Understandability.
   d. Verifiability.

30. Under Statement of Financial Accounting Concepts No. 2, which of the following is an ingredient of the primary quality of reliability?
   a. Understandability.
   b. Verifiability.
   c. Predictive value.
   d. Materiality.

31. Company X acquired for cash all of the outstanding common stock of Company Y. How should Company X determine in general the amounts to be reported for the inventories and long-term debt acquired from Company Y?

	Inventories	*Long-term debt*
a.	Fair value	Fair value
b.	Fair value	Recorded value
c.	Recorded value	Fair value
d.	Recorded value	Recorded value

32. An inventory loss from a market decline occurred in the first quarter that was not expected to be restored in the fiscal year. For interim financial reporting purposes, how would the dollar amount of inventory in the balance sheet be affected in the first and fourth quarters?

	First quarter	*Fourth quarter*
a.	Decrease	No effect
b.	Decrease	Increase
c.	No effect	Decrease
d.	No effect	No effect

33. When computing information on a historical cost/constant dollar basis, which of the following is classified as monetary?

a. Obligations under warranties.
b. Inventories, other than inventories used on contracts.
c. Trademarks.
d. Accrued losses on firm purchase commitments.

34. When measuring the current cost of inventories in accordance with FASB Statement No. 33, the "entry" date can mean which of the following?

	Beginning of year	*Date of sale*
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

35. Costs incurred in effecting a business combination accounted for as a pooling of interests should be

a. Added to the cost of the investment account of the parent corporation.
b. Deducted from additional paid-in capital of the combined corporation.
c. Deducted in determining net income of the combined corporation for the period in which the costs were incurred.
d. Capitalized and subsequently amortized over a period not exceeding forty years.

36. Which of the following should be disclosed in the Summary of Significant Accounting Policies?

a. Composition of plant assets.
b. Pro forma effect of retroactive application of an accounting change.
c. Basis of consolidation.
d. Maturity dates of long-term debt.

37. A clearly identified appropriation of retained earnings for reasonably possible loss contingencies should be

a. Charged with all losses related to that contingency.
b. Transferred to income as losses are realized.
c. Classified in the liability section of the balance sheet.
d. Shown within the stockholders' equity section of the balance sheet.

38. The calculation of the income recognized in the second year of a four-year construction contract which is accounted for using the percentage-of-completion method is based on the

a. Latest available estimated costs.
b. Cumulative actual costs incurred only.
c. Incremental cost for the second year only.
d. Estimated costs at the inception of the contract.

39. For its defined benefit pension plans, an employer should disclose for each complete set of financial statements, as of the most recent benefit information date for which the data are available, the actuarial present value of accumulated plan benefits that are

	Vested	*Nonvested*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

40. How are the following used in the calculation of the dividend payout ratio for a company with only common stock outstanding?

	Dividends per share	*Earnings per share*	*Book value per share*
a.	Denominator	Numerator	Not used
b.	Denominator	Not used	Numerator
c.	Numerator	Denominator	Not used
d.	Numerator	Not used	Denominator

41. An actual cost system may be used in

a. Neither process costing nor job order costing.
b. Process costing but **not** job order costing.
c. Job order costing but **not** process costing.
d. Both job order costing and process costing.

42. Wages of the security guard for a small plant would be an example of

	Indirect labor	*Fixed factory overhead*
a.	No	No
b.	Yes	Yes
c.	Yes	No
d.	No	Yes

43. The percentage of completion of the beginning work-in-process inventory should be included in the computation of the equivalent units of production for which of the following methods of process costing?

	First in, first-out	*Weighted-average*
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

44. Relative sales value at split-off is used to allocate

	Costs beyond split-off	*Joint costs*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

45. Which of the following is (are) acceptable regarding the allocation of joint product cost to a by-product?

	None allocated	*Some portion allocated*
a.	Acceptable	Not acceptable
b.	Acceptable	Acceptable
c.	Not acceptable	Acceptable
d.	Not acceptable	Not acceptable

46. When using a flexible budget, what will occur to fixed costs (on a per unit basis) as production increases within the relevant range?

a. Fixed costs are **not** considered in flexible budgeting.
b. Fixed costs per unit will decrease.
c. Fixed costs per unit will increase.
d. Fixed costs per unit will remain unchanged.

47. Multiple regression analysis

a. Establishes a cause and effect relationship.
b. Does **not** produce measures of probable error.
c. Measures the change in one variable associated with the change in one other variable.
d. Measures the change in one variable associated with the change in more than one other variable.

48. The difference between the actual labor rate multiplied by the actual labor hours worked and the standard labor rate multiplied by the standard labor hours is the

a. Total labor variance.
b. Labor rate variance.
c. Labor usage variance.
d. Labor efficiency variance.

49. The order size determined by the economic order quantity formula minimizes the annual inventory cost which is comprised of ordering cost and

a. Safety-stock cost.
b. Stock-out cost.
c. Set-up cost.
d. Carrying cost.

50. The standard unit cost is used in the calculation of which of the following variances?

	Materials price variance	*Materials usage variance*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

51. Which of the following accounts of a governmental unit is (are) closed out at the end of the fiscal year?

	Estimated revenues	*Fund balance*
a.	No	No
b.	No	Yes
c.	Yes	Yes
d.	Yes	No

52. Which of the following accounts of a governmental unit is credited when a purchase order is approved?

a. Reserve for encumbrances.
b. Encumbrances.
c. Vouchers payable.
d. Appropriations.

53. Repairs that have been made for a governmental unit, and for which a bill has been received, should be recorded in the general fund as a debit to an

a. Expenditure.
b. Encumbrance.
c. Expense.
d. Appropriation.

54. A debt service fund of a municipality is an example of which of the following types of fund?

a. Fiduciary.
b. Governmental.
c. Proprietary.
d. Internal service.

55. Revenues of a special revenue fund of a governmental unit should be recognized in the period in which the
   a. Revenues become available and measurable.
   b. Revenues become available for appropriation.
   c. Revenues are billable.
   d. Cash is received.

56. Which of the following funds of a governmental unit would use the general long-term debt account group to account for unmatured general long-term liabilities?
   a. Special assessment.
   b. Capital projects.
   c. Trust.
   d. Internal service.

57. Which of the following funds of a governmental unit uses the same basis of accounting as an enterprise fund?
   a. Special revenue.
   b. Internal service.
   c. Expendable trust.
   d. Capital projects.

58. Which of the following funds of a governmental unit could use the general fixed assets account group to account for fixed assets?
   a. Internal service.
   b. Enterprise.
   c. Trust.
   d. Special assessment.

59. A state governmental unit should use which basis of accounting for each of the following types of funds?

	Governmental	*Proprietary*
a.	Cash	Modified accrual
b.	Modified accrual	Modified accrual
c.	Modified accrual	Accrual
d.	Accrual	Accrual

60. An unrestricted pledge from an annual contributor to a voluntary not-for-profit hospital made in December 1981 and paid in cash in March 1982 would generally be credited to
   a. Nonoperating revenue in 1981.
   b. Nonoperating revenue in 1982.
   c. Operating revenue in 1981.
   d. Operating revenue in 1982.

Number 2 (Estimated time —— 15 to 25 minutes)

Part a. On July 1, 1981, Carme Company, a calendar-year company, sold special-order merchandise on credit and received in return an interest-bearing note receivable from the customer. Carme Company will receive interest at the prevailing rate for a note of this type. Both the principal and interest are due in one lump sum on June 30, 1982.

Required:
1. When should Carme Company report interest income from the note receivable? Discuss the rationale for your answer.

2. Assume that the note receivable was discounted without recourse at a bank on December 31, 1981. How would Carme Company determine the amount of the discount and what is the appropriate accounting for the discounting transaction?

Part b. On December 31, 1981, Carme Company had significant amounts of accounts receivable as a result of credit sales to its customers. Carme Company uses the allowance method based on credit sales to estimate bad debts. Based on past experience, 1% of credit sales normally will not be collected. This pattern is expected to continue.

Required:
1. Discuss the rationale for using the allowance method based on credit sales to estimate bad debts. Contrast this method with the allowance method based on the balance in the trade receivables accounts.

2. How should Carme Company report the allowance for bad debts account on its balance sheet at December 31, 1981? Also, describe the alternatives, if any, for presentation of bad debt expense in Carme Company's 1981 income statement.

Number 3 (Estimated time —— 15 to 25 minutes)

On February 1, 1979, Aubrey Company sold its 5-year, $1,000 par value, 8% bonds which were convertible at the option of the investor into Aubrey Company common stock at a ratio of 10 shares of common stock for each bond. The convertible bonds were sold by Aubrey Company at a discount. Interest is payable annually each February 1. On February 1, 1982, Mel Company, an investor in the Aubrey Company convertible bonds, tendered 1,000 bonds for conversion into 10,000 shares of Aubrey Company common stock which had a market value of $110 per share at the date of the conversion.

On May 1, 1982, Aubrey Company sold its 10-year, $1,000 par value, 14% nonconvertible term bonds dated April 1, 1982. Interest is payable semiannually and the first interest payment date is October 1, 1982. Due to market conditions, the bonds were sold at an effective interest rate (yield) of 16%.

Required:

a. How should Aubrey Company account for the conversion of the convertible bonds into common stock under both the book value and market value methods? Discuss the rationale for each method.

b. Were the nonconvertible term bonds sold at par, at a discount, or at a premium? Discuss the rationale for your answer.

c. Identify and discuss the effects on Aubrey Company's 1982 income statement associated with the nonconvertible term bonds.

Number 4 (Estimated time —— 15 to 25 minutes)

Part a. Grisp Company, a manufacturer with heavy investments in property, plant, and equipment, is presently using absorption costing for both its external and internal reporting. The management of Grisp Company is considering using the direct costing method for internal reporting only.

Required:

1. What would be the rationale for using the direct costing method for internal reporting?
2. Assuming that the quantity of ending inventory is higher than the quantity of beginning inventory, would operating income using direct costing be different from operating income using absorption costing? If so, specify if it would be higher or lower. Discuss the rationale for your answer.

Part b. The net present value method and the internal rate of return method are both sophisticated capital budgeting techniques.

Required:

1. State the advantages that both the net present value method and the internal rate of return method have over the payback method.
2. State the limitations of the net present value method.
3. State the limitations of the internal rate of return method.
4. How does each method (net present value and internal rate of return) handle depreciation? Discuss the rationale for your answer. Ignore income tax considerations in your answer.

Number 5 (Estimated time —— 15 to 25 minutes)

David Company's Statements of Income for the year ended December 31, 1981, and December 31, 1980 are presented below:

David Company
STATEMENTS OF INCOME

	Year ended December 31,	
	1981	*1980*
	(000 omitted)	
Net sales	$900,000	$750,000
Costs and expenses:		
Cost of goods sold	720,000	600,000
Selling, general and administrative expenses	112,000	90,000
Other, net	11,000	9,000
Total costs and expenses	843,000	699,000
Income from continuing operations before income taxes	57,000	51,000
Income taxes	23,000	24,000
Income from continuing operations	34,000	27,000
Loss on disposal of Dex Division, including provision of $1,500,000 for operating losses during phase-out period, less applicable income taxes of $8,000,000	8,000	—
Cumulative effect on prior years of change in depreciation method, less applicable income taxes of $1,500,000	—	3,000
Net income	$ 26,000	$ 30,000
Earnings per share of common stock:		
Income before cumulative effect of change in depreciation method	$ 2.60	$ 2.70
Cumulative effect on prior years of change in depreciation method, less applicable income taxes	—	.30
Net income	$ 2.60	$ 3.00

Additional facts are as follows:

- On January 1, 1980, David Company changed its depreciation method for previously recorded plant machinery from the double-declining-balance method to the straight-line method. The effect of applying the straight-line method for the year of and the year after the change is included in David Company's Statements of Income for the year ended December 31, 1981, and December 31, 1980, in "cost of goods sold."
- The loss from operations of the discontinued Dex Division from January 1, 1981, to September 30, 1981, (the portion of the year prior to the measurement date) and from January 1, 1980, to December 31, 1980, is included in David Company's Statements of Income for the year ended December 31, 1981, and December 31, 1980, respectively, in "other, net."
- David Company has a simple capital structure with only common stock outstanding and the net income per share of common stock was based on the weighted average number of common shares outstanding during each year.
- David Company common stock is listed on the New York Stock Exchange and closed at $13 per share on December 31, 1981, and $15 per share on December 31, 1980.

Required:

a. Determine from the additional facts above whether the presentation of those facts in David Company's Statements of Income is appropriate. If the presentation is appropriate, discuss the theoretical rationale for the presentation. If the presentation is not appropriate, specify the appropriate presentation and discuss its theoretical rationale.

Do not discuss disclosure requirements for the Notes to the Financial Statements.

b. Describe the general significance of the price-earnings ratio. Based on David Company's Statements of Income, and the additional facts above, describe how to determine the price-earnings ratio for 1981 only.

Uniform Certified Public Accountant Examination

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN ACCOUNTING PRACTICE — PART I

May 4, 1983; 1:30 to 6:00 P.M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

	Estimated Minutes	
All questions are required:	*Minimum*	*Maximum*
No. 1	45	55
No. 2	45	55
No. 3	45	55
No. 4	45	55
No. 5	40	50
Total	220	270

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers. Since objective items are computer-graded, your comments and calculations associated with them are not considered.

3. For problem-type questions you should enclose all scratch sheets. Failure to enclose scratch sheets may result in loss of grading points. Scratch sheets need not have page numbers, but you should show the question number and place them immediately following the question to which they relate.

4. Fourteen-column sheets, if any, should not be folded until all sheets, both wide and narrow, are placed in the proper sequence and fastened together at the top left corner. All fourteen-column sheets should then be wrapped around the back of the papers.

5. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of financial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

97. Gross billings for merchandise sold by Baker Company to its customers last year amounted to $5,260,000; sales returns and allowances reduced the amounts owed by $160,000. How much were net sales last year for Baker Company?

a. $4,800,000
b. $5,100,000
c. $5,200,000
d. $5,260,000

Answer Sheet

97. ⓐ ● ⓒ ⓓ

Items to be Answered

1. The balance in Ashwood Company's accounts payable account at December 31, 1982, was $900,000 before any necessary year-end adjustment relating to the following:

- Goods were in transit from a vendor to Ashwood on December 31, 1982. The invoice cost was $50,000, and the goods were shipped F.O.B. shipping point on December 29, 1982. The goods were received on January 4, 1983.
- Goods shipped F.O.B. shipping point on December 20, 1982, from a vendor to Ashwood were lost in transit. The invoice cost was $25,000. On January 5, 1983, Ashwood filed a $25,000 claim against the common carrier.
- Goods shipped F.O.B. destination on December 21, 1982, from a vendor to Ashwood were received on January 6, 1983. The invoice cost was $15,000.

What amount should Ashwood report as accounts payable on its December 31, 1982, balance sheet?

a. $925,000
b. $940,000
c. $950,000
d. $975,000

2. During 1982 Anthony Company purchased marketable equity securities as a long-term investment. Pertinent data are as follows:

Security	*Cost*	*Market value at 12/31/82*
A	$ 20,000	$ 18,000
B	40,000	30,000
C	90,000	93,000
	$150,000	$141,000

Anthony appropriately carries these securities at the lower of aggregate cost or market value. The amount of unrealized loss on these securities to flow through Anthony's income statement for 1982 should be

a. $0
b. $ 3,000
c. $ 9,000
d. $12,000

3. On January 1, 1982, Weaver Company purchased as a long-term investment $500,000 face value of Park Corporation's 8% bonds for $456,200. The bonds were purchased to yield 10% interest. The bonds mature on January 1, 1988, and pay interest annually on January 1. Weaver uses the interest method of amortization. What amount should Weaver report on its December 31, 1982, balance sheet as long-term investment?

a. $450,580
b. $456,200
c. $461,820
d. $466,200

4. On April 1, 1983, Union Company paid $1,600,000 for all the issued and outstanding common stock of Cable Corporation in a transaction properly accounted for as a purchase. The recorded assets and liabilities of Cable on April 1, 1983, were as follows:

Cash	$160,000
Inventory	480,000
Property, plant and equipment (net)	960,000
Liabilities	(360,000)

On April 1, 1983, it was determined that Cable's inventory had a fair value of $460,000, and the property, plant and equipment (net) had a fair value of $1,040,000. What is the amount of goodwill resulting from the business combination?

a. $0
b. $ 20,000
c. $300,000
d. $360,000

5. On January 4, 1982, Hadley Company signed a 10-year nonrenewable lease for a building to be used in its manufacturing operations. During January 1982 Hadley incurred the following costs:

- $64,000 for general improvements to the leased premises with an estimated useful life of eight years.
- $32,000 for a movable assembly line equipment installation with an estimated useful life of eight years.

A full year's amortization is taken for the calendar year 1982. What amount should Hadley record as amortization of leasehold improvements for 1982?

a. $ 6,400
b. $ 8,000
c. $ 9,600
d. $12,000

6. Under Gerber Company's accounting system, all insurance premiums paid are debited to prepaid insurance. For interim financial statements, Gerber makes monthly estimated charges to insurance expense with an offset to prepaid insurance. Additional information for the year ended December 31, 1982, is as follows:

Prepaid insurance at December 31, 1981	$150,000
Charges to insurance expense during 1982 (including a year-end adjustment of $25,000)	625,000
Unexpired insurance premiums at December 31, 1982	175,000

What was the total amount of insurance premiums paid by Gerber during 1982?

a. $475,000
b. $600,000
c. $625,000
d. $650,000

7. Morgan Company determined that: (1) it has a material obligation relating to employees' rights to receive compensation for future absences attributable to employees' services already rendered, (2) the obligation relates to rights that vest, and (3) payment of the compensation is probable. The amount of Morgan's obligation as of December 31, 1982, is reasonably estimated for the following employee benefits:

Vacation pay	$100,000
Holiday pay	25,000

What total amount should Morgan report as its liability for compensated absences in its December 31, 1982, balance sheet?

a. $0
b. $ 25,000
c. $100,000
d. $125,000

8. On December 31, 1981, Dumont Corporation had outstanding 8%, $2,000,000 face value convertible bonds maturing on December 31, 1985. Interest is payable annually on December 31. Each $1,000 bond is convertible into 60 shares of Dumont's $10 par value common stock. The unamortized balance on December 31, 1982, in the premium on bonds payable account was $45,000. On December 31, 1982, an individual holding 200 of the bonds exercised the conversion privilege when the market value of Dumont's common stock was $18 per share. Using the book value method, Dumont's entry to record the conversion should include a credit to additional paid-in capital of

a. $ 80,000
b. $ 84,500
c. $ 96,000
d. $125,000

9. The books of Curtis Company for the year ended December 31, 1982, showed income of $360,000 before provision for income tax. In computing the taxable income for federal income tax purposes, the following differences were taken into account:

Depreciation deducted for tax purposes in excess of depreciation recorded on the books	$16,000
Income from installment sale reportable for tax purposes in excess of income recognized on the books	12,000

Assuming a corporate income tax rate of 40%, what should Curtis record as its current federal income tax liability at December 31, 1982?

a. $137,600
b. $142,400
c. $144,000
d. $145,600

10. Starr Trading Stamp Company records stamp service revenue and provides for the cost of redemptions in the year stamps are furnished to licensees. Starr's past experience indicates that only 90% of the stamps sold to licensees will be redeemed. Starr's liability for stamp redemptions was $18,000,000 at December 31, 1981. Additional information for 1982 is as follows:

Stamp service revenue from stamps furnished to licensees	$10,000,000
Cost of redemptions	$ 8,500,000
Estimated cost of future redemptions as a percentage of stamps redeemable	60%

What amount should Starr report as a liability for stamp redemptions at December 31, 1982?

a. $ 9,500,000
b. $14,900,000
c. $18,500,000
d. $19,500,000

11. On July 1, 1976, Belmont Corporation issued for $960,000, one thousand of its 9%, $1,000 callable bonds. The bonds are dated July 1, 1976, and mature on July 1, 1986. Interest is payable semiannually on January 1 and July 1. Belmont uses the straight-line method of amortizing bond discount. The bonds can be called by the issuer at 101 at any time after June 30, 1981.

On July 1, 1982, Belmont called in all of the bonds and retired them. Ignoring income taxes, how much loss should Belmont report on this early extinguishment of debt for the year ended December 31, 1982?

a. $50,000
b. $34,000
c. $26,000
d. $10,000

12. Saratoga, Inc., owns 75% of the voting common stock of its domestic subsidiary, Bell Corporation. During 1982 Bell reported earnings of $150,000 and paid dividends of $50,000. Saratoga assumes that all of the undistributed earnings of Bell will be distributed as dividends in future periods. Assuming that Saratoga's income tax rate is 40%, the amount of deferred tax to be reported for 1982 is

a. $ 4,500
b. $ 6,750
c. $30,000
d. $40,000

13. Dell Company sells its products in reusable, expensive containers. The customer is charged a deposit for each container delivered and receives a refund for each container returned within two years after the year of delivery. Dell accounts for the containers not returned within the time limit as being retired by sale at the deposit amount. Information for 1982 is as follows:

Containers held by customers at December 31, 1981, from deliveries in:		
1980	$ 50,000	
1981	145,000	$195,000
Containers delivered in 1982		260,000
Containers returned in 1982 from deliveries in:		
1980	30,000	
1981	85,000	
1982	95,000	210,000

What amount should Dell report as a liability for returnable containers at December 31, 1982?

a. $165,000
b. $215,000
c. $225,000
d. $245,000

14. Bricker Company is indebted to Springburn Bank under a $200,000, 16%, three-year note dated January 1, 1981. Interest, payable annually on December 31, was paid on the December 31, 1981, due date. During 1982 Bricker experienced severe financial difficulties and is likely to default on the note and interest unless a concession is made by the bank. On December 31, 1982, the bank agreed to settle the note and interest for 1982 for $10,000 cash and a tract of land having a current market value of $140,000. Bricker's acquisition cost of the land is $100,000. Ignoring income taxes, what amount should Bricker report as extraordinary gain on the debt restructure in its income statement for the year ended December 31, 1982?

a. $0
b. $ 50,000
c. $ 82,000
d. $122,000

15. Victor Corporation was organized on January 2, 1982, with 100,000 authorized shares of $10 par value common stock. During 1982 Victor had the following capital transactions:

- January 5—issued 75,000 shares at $14 per share.
- December 27—purchased 5,000 shares at $11 per share.

Victor used the par value method to record the purchase of the treasury shares. What would be the balance in the paid-in capital from treasury stock account at December 31, 1982?

a. $0
b. $ 5,000
c. $15,000
d. $20,000

16. On December 31, 1982, Tower Pizza, Inc., signed an agreement authorizing Greene Company to operate as a franchisee for an initial franchise fee of $50,000. Of this amount, $20,000 was received upon signing of the agreement and the balance is due in three annual payments of $10,000 each beginning December 31, 1983. The agreement provides that the down payment (representing a fair measure of the services already performed by Tower) is not refundable and substantial future services are required of Tower. Greene's credit rating is such that collection of the note is reasonably certain. The present value at December 31, 1982, of the three annual payments discounted at 14% (the implicit rate for a loan of this type) is $23,220. On December 31, 1982, Tower should record unearned franchise fees in respect of the Greene franchise of

a. $23,220
b. $30,000
c. $43,220
d. $50,000

17. Wildwood Company's usual sales terms are net 60 days, F.O.B. shipping point. Sales, net of returns and allowances, totaled $2,000,000 for the year ended December 31, 1982, before year-end adjustment. Additional information is as follows:

- Goods with an invoice amount of $40,000 were billed to a customer on January 3, 1983. The goods were shipped on December 31, 1982.
- On January 5, 1983, a customer notified Wildwood that goods billed and shipped to it on December 21, 1982, were lost in transit. The invoice amount was $50,000.
- On December 27, 1982, Wildwood authorized a customer to return, for full credit, goods shipped and billed at $25,000 on December 15, 1982. The returned goods were received by Wildwood on January 4, 1983, and a $25,000 credit memo was issued on the same date.

Wildwood's adjusted net sales for 1982 should be
a. $1,965,000
b. $1,975,000
c. $1,990,000
d. $2,015,000

18. Paulson Company had inventories at the beginning and end of 1982 as follows:

	1/1/82	*12/31/82*
Raw materials	$55,000	$65,000
Work-in-process	96,000	80,000
Finished goods	50,000	85,000

During 1982 the following costs were incurred:

Raw materials purchased	$400,000
Direct-labor payroll	220,000
Factory overhead	330,000

Paulson's cost of goods sold for 1982 was
a. $921,000
b. $956,000
c. $966,000
d. $979,000

19. On January 1, 1982, Jaffe Corporation issued at 95, five hundred of its 9%, $1,000 bonds. Interest is payable semiannually on July 1 and January 1, and the bonds mature on January 1, 1992. Jaffe paid bond issue costs of $20,000 which are appropriately recorded as a deferred charge. Jaffe uses the straight-line method of amortizing bond discount and bond issue costs. On Jaffe's December 31, 1982, balance sheet, the bonds payable should be reported at their carrying value of
a. $459,500
b. $477,500
c. $495,500
d. $522,500

20. Greenfield Company had the following cash balances at December 31, 1982:

Cash in banks	$1,500,000
Petty cash funds (all funds were reimbursed on December 31, 1982)	20,000
Cash legally restricted for additions to plant (expected to be disbursed in 1984)	2,000,000

Cash in banks includes $500,000 of compensating balances against short-term borrowing arrangements at December 31, 1982. The compensating balances are not legally restricted as to withdrawal by Greenfield. In the current assets section of Greenfield's December 31, 1982, balance sheet, what total amount should be reported as cash?
a. $1,020,000
b. $1,520,000
c. $3,020,000
d. $3,520,000

Number 2 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of managerial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

21. Walden Company has a process cost system using the FIFO cost flow method. All materials are introduced at the beginning of the process in department One. The following information is available for the month of January 1983:

	Units
Work-in-process, 1/1/83 (40% complete as to conversion costs)	500
Started in January	2,000
Transferred to department Two during January	2,100
Work-in-process, 1/31/83 (25% complete as to conversion costs)	400

What are the equivalent units of production for the month of January 1983?

	Materials	*Conversion*
a.	2,500	2,200
b.	2,500	1,900
c.	2,000	2,200
d.	2,000	2,000

Items 22 and 23 are based on the following information:

Summit Company provided the following inventory balances and manufacturing cost data for the month of January 1983:

Inventories:	*1/1/83*	*1/31/83*
Direct materials	$30,000	$40,000
Work-in-process	15,000	20,000
Finished goods	65,000	50,000

	Month of January 1983
Cost of goods manufactured	$515,000
Factory overhead applied	150,000
Direct materials used	190,000
Actual factory overhead	144,000

Under Summit's cost system, any over or underapplied overhead is closed to the cost of goods sold account at the end of the calendar year.

22. What was the total amount of direct-material purchases during January 1983?
   a. $180,000
   b. $190,000
   c. $195,000
   d. $200,000

23. How much direct-labor cost was incurred during January 1983?
   a. $170,000
   b. $175,000
   c. $180,000
   d. $186,000

24. Elliott Company manufactures tools to customer specifications. The following data pertain to Job 1501 for February 1983:

Direct materials used	$ 4,200
Direct-labor hours worked	300
Direct-labor rate per hour	$ 8.00
Machine hours used	200
Applied factory overhead rate per machine hour	$ 15.00

What is the total manufacturing cost recorded on Job 1501 for February 1983?
   a. $ 8,800
   b. $ 9,600
   c. $10,300
   d. $11,100

25. The following information is available for Trencher Company's material B:

Annual usage in units	10,000
Working days per year	250
Safety stock in units	400
Normal lead time in working days	30

Assuming that the units of material B will be required evenly throughout the year, the order point would be
   a. 400
   b. 800
   c. 1,200
   d. 1,600

Items 26 through 28 are based on the following information:

Wayne Company had the following inventories at the beginning and end of March 1983:

	3/1/83	3/31/83
Direct materials	$36,000	$30,000
Work-in-process	18,000	12,000
Finished goods	54,000	72,000

The following additional manufacturing cost data were available for the month of March 1983:

Direct materials purchased	$84,000
Direct-labor payroll	60,000
Direct-labor rate per hour	7.50
Factory overhead rate per direct-labor hour	10.00

26. During March 1983 prime cost added to production was
   a. $ 90,000
   b. $140,000
   c. $144,000
   d. $150,000

27. During March 1983 conversion cost added to production was
   a. $ 60,000
   b. $ 80,000
   c. $140,000
   d. $150,000

28. The cost of goods manufactured for March 1983 was
   a. $212,000
   b. $218,000
   c. $230,000
   d. $236,000

29. During April 1983 Clayton Company's department B equivalent unit product costs, computed under the weighted-average method, were as follows:

Materials	$1
Conversion	3
Transferred-in	5

Materials are introduced at the end of the process in department B. There were 2,000 units (40% complete as to conversion costs) in work-in-process at April 30, 1983. The total costs assigned to the April 30, 1983, work-in-process inventory should be

a. $12,400
b. $13,600
c. $14,400
d. $18,000

30. Barkley Company adds materials at the beginning of the process in department M. Data concerning the materials used in March 1983 production are as follows:

	Units
Work-in-process at March 1	16,000
Started during March	34,000
Completed and transferred to next department during March	36,000
Normal spoilage incurred	4,000
Work-in-process at March 31	10,000

Using the weighted-average method, the equivalent units for the materials unit cost calculation are

a. 30,000
b. 34,000
c. 40,000
d. 46,000

31. Lawton Company produces canned tomato soup and is budgeting sales of 250,000 units for the month of January 1983. Actual inventory units at January 1 and budgeted inventory units at January 31 are as follows:

	Units
Actual inventory at January 1:	
Work-in-process	None
Finished goods	75,000
Budgeted inventory at January 31:	
Work-in-process (75% processed)	16,000
Finished goods	60,000

How many equivalent units of production is Lawton budgeting for January 1983?

a. 235,000
b. 247,000
c. 251,000
d. 253,000

32. Blackwood uses a job order cost system and applies factory overhead to production orders on the basis of direct-labor cost. The overhead rates for 1982 are 200% for department A and 50% for department B. Job 123, started and completed during 1982, was charged with the following costs:

	Department	
	A	*B*
Direct materials	$25,000	$ 5,000
Direct labor	?	30,000
Factory overhead	40,000	?

The total manufacturing costs associated with Job 123 should be

a. $135,000
b. $180,000
c. $195,000
d. $240,000

Items 33 and 34 are based on the following information:

Gordon Company began its operations on January 1, 1982, and produces a single product that sells for $10 per unit. Gordon uses an actual (historical) cost system. In 1982, 100,000 units were produced and 80,000 units were sold. There was no work-in-process inventory at December 31, 1982.

Manufacturing costs and selling and administrative expenses for 1982 were as follows:

	Fixed costs	*Variable costs*
Raw materials	—	$2.00 per unit produced
Direct labor	—	1.25 per unit produced
Factory overhead	$120,000	.75 per unit produced
Selling and administrative	70,000	1.00 per unit sold

33. What would be Gordon's operating income for 1982 under the variable (direct) costing method?

a. $114,000
b. $210,000
c. $234,000
d. $330,000

34. What would be Gordon's finished goods inventory at December 31, 1982, under the absorption costing method?

a. $ 80,000
b. $104,000
c. $110,000
d. $124,000

Items 35 and 36 are based on the following information:

Warfield Corporation manufactures products C, D and E from a joint process. Joint costs are allocated on the basis of relative-sales-value at split-off. Additional information is as follows:

	Product			
	C	*D*	*E*	*Total*
Units produced	6,000	4,000	2,000	12,000
Joint costs	$ 72,000	?	?	$120,000
Sales value at split-off	?	?	$30,000	$200,000
Additional costs if processed further	$ 14,000	$10,000	$ 6,000	$ 30,000
Sales value if processed further	$140,000	$60,000	$40,000	$240,000

35. How much of the joint costs should Warfield allocate to product D?
   a. $24,000
   b. $28,800
   c. $30,000
   d. $32,000

36. Assuming that the 2,000 units of product E were processed further and sold for $40,000, what was Warfield's gross profit on the sale?
   a. $ 4,000
   b. $14,000
   c. $16,000
   d. $22,000

37. Simpson Company manufactures electric drills to the exacting specifications of various customers. During April 1983, Job 403 for the production of 1,100 drills was completed at the following costs per unit:

Direct materials	$10
Direct labor	8
Applied factory overhead	12
	$30

Final inspection of Job 403 disclosed 50 defective units and 100 spoiled units. The defective drills were reworked at a total cost of $500 and the spoiled drills were sold to a jobber for $1,500. What would be the unit cost of the good units produced on Job 403?
   a. $33
   b. $32
   c. $30
   d. $29

38. Crowley Company produces joint products A and B from a process which also yields a by-product, Y. The by-product requires additional processing before it can be sold. The cost assigned to the by-product is its market value less additional costs incurred after split-off (net realizable value method). Information concerning a batch produced in January 1983 at a joint cost of $40,000 is as follows:

Product	*Units produced*	*Market value*	*Costs after split-off*
A	800	$44,000	$4,500
B	700	32,000	3,500
Y	500	4,000	1,000

How much of the joint cost should be allocated to the joint products?
   a. $35,000
   b. $36,000
   c. $37,000
   d. $39,000

39. Universal Company uses a standard cost system and prepared the following budget at normal capacity for the month of January 1983:

Direct-labor hours	24,000
Variable factory overhead	$ 48,000
Fixed factory overhead	$108,000
Total factory overhead per direct-labor hour	$ 6.50

Actual data for January 1983 were as follows:

Direct-labor hours worked	22,000
Total factory overhead	$147,000
Standard direct-labor hours allowed for capacity attained	21,000

Using the two-way analysis of overhead variances, what is the budget (controllable) variance for January 1983?
   a. $ 3,000 favorable.
   b. $ 5,000 favorable.
   c. $ 9,000 favorable.
   d. $10,500 unfavorable.

40. Dillon, Inc., purchased a new machine for $60,000 on January 1, 1983. The machine is being depreciated on the straight-line basis over five years with no salvage value. The accounting (book-value) rate of return is expected to be 15% on the initial increase in required investment. Assuming a uniform cash flow, this investment is expected to provide annual cash flow from operations, net of income taxes, of
   a. $ 7,200
   b. $12,000
   c. $13,800
   d. $21,000

Number 3 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **the federal income taxation of individuals.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **The answers should be based upon 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. Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

41. Dr. Chester is a cash basis taxpayer. His office visit charges are usually paid on the date of visit or within one month. However, services rendered outside the office are billed weekly, and are usually paid within two months as patients collect from insurance companies. Information relating to 1982 is as follows:

Cash received at the time of office visits	$ 35,000
Collections on accounts receivable	130,000
Accounts receivable, January 1	16,000
Accounts receivable, December 31	20,000

Dr. Chester's gross income from his medical practice for 1982 is

a. $165,000
b. $169,000
c. $181,000
d. $185,000

42. Paul Bristol, a cash basis taxpayer, owns an apartment building. The following information was available for 1982:

- An analysis of the 1982 bank deposit slips showed recurring monthly rents received totaling $50,000.
- On March 1, 1982, the tenant in apartment 2B paid Bristol $2,000 to cancel the lease expiring on December 31, 1982.
- The lease of the tenant in apartment 3A expired on December 31, 1982, and the tenant left improvements valued at $1,000. The improvements were not in lieu of any rent required to have been paid.

In computing net rental income for 1982, Bristol should report gross rents of

a. $50,000
b. $51,000
c. $52,000
d. $53,000

43. Anthony and Lucy Grady were divorced in May 1982. In accordance with the decree, Anthony made the following payments to Lucy in 1982:

Lump-sum cash settlement	$25,000
Indefinite periodic payments	15,000

How much should Lucy include in her 1982 taxable income as alimony (separate maintenance)?

a. $40,000
b. $25,000
c. $15,000
d. $0

44. For the year 1982 Diana Clark had salary income of $38,000. In addition she had the following capital transactions during the year:

Long-term capital gain	$14,000
Short-term capital gain	6,000
Long-term capital loss	(4,000)
Short-term capital loss	(8,000)

There were no other items includible in her gross income. What is her adjusted gross income for 1982?

a. $38,000
b. $41,200
c. $42,800
d. $46,000

45. The following information is available for Ann Drury for 1982:

Salary	$36,000
Premiums paid by employer on group-term life insurance in excess of $50,000	500
Proceeds from state lottery	5,000

How much should Drury report as gross income on her 1982 tax return?

a. $36,000
b. $36,500
c. $41,000
d. $41,500

46. Charles Gilbert, a corporate executive, incurred business-related, unreimbursed expenses in 1982 as follows:

Entertainment	$900
Travel	700
Education	400

Assuming that Gilbert does not itemize deductions, how much of these expenses should he deduct on his 1982 tax return?

a. $ 700
b. $1,100
c. $1,300
d. $1,600

47. On July 1, 1982, Riley exchanged investment real property, with an adjusted basis of $160,000 and subject to a mortgage of $70,000, and received from Wilson $30,000 cash and other investment real property having a fair market value of $250,000. Wilson assumed the mortgage. What is Riley's recognized gain in 1982 on the exchange?

a. $ 30,000
b. $ 70,000
c. $ 90,000
d. $100,000

48. On July 1, 1982, Daniel Wright owned stock (held for investment) purchased two years earlier at a cost of $10,000 and having a fair market value of $7,000. On this date he sold the stock to his son, William, for $7,000. William sold the stock for $6,000 to an unrelated person on November 1, 1982. How should William report the stock sale (before any deduction) on his 1982 tax return?

a. As a short-term capital loss of $1,000.
b. As a long-term capital loss of $1,000.
c. As a short-term capital loss of $4,000.
d. As a long-term capital loss of $4,000.

49. William Dalton, age 30 and single, provided the following information for his 1982 income tax return:

Salary	$30,000
Payment to an Individual Retirement Account	$ 2,000
Total itemized deductions	$ 3,400
Number of exemptions claimed	1

Dalton should report taxable income for 1982 of

a. $24,600
b. $25,900
c. $26,900
d. $27,900

50. Robert and Judy Parker made the following payments during 1982:

Interest on a life insurance policy loan (the related policy on Robert's life was purchased in 1950)	$1,200
Interest on home mortgage for period January 1 to October 4, 1982	3,600
Penalty payment for prepayment of home mortgage on October 4, 1982	900

How much can the Parkers utilize as interest expense in calculating excess itemized deductions for 1982?

a. $5,700
b. $4,800
c. $4,500
d. $3,600

51. Henry Warren did not itemize his deductions on his 1981 and 1980 federal income tax returns. However, Warren plans to itemize his deductions for 1982. The following information relating to his state income taxes is available:

Taxes withheld in 1982	$2,000
Refund received in 1982 of 1981 tax	300
Assessment paid in 1982 of 1980 tax	200

What amount should Warren utilize as state and local income taxes in calculating excess itemized deductions for his 1982 federal income tax return?

a. $1,700
b. $1,900
c. $2,000
d. $2,200

52. Ruth Lewis has adjusted gross income of $100,000 for 1982 and itemizes her deductions. On September 1, 1982, she made a contribution to her church of stock held for investment for two years which cost $10,000 and had a fair market value of $70,000. The church sold the stock for $70,000 on the same date. Assume that Lewis made no other contributions during 1982 and made no special election in regard to this contribution on her 1982 tax return. How much should Lewis claim as a charitable contribution deduction for 1982?

a. $50,000
b. $30,000
c. $20,000
d. $10,000

53. Mary and Robert Allen were granted a divorce in 1982. In accordance with the decree, Robert made the following payments to Mary in 1982:

Lump-sum cash settlement	$20,000
Indefinite periodic payments	12,000

How much of the payments should Robert deduct in arriving at his adjusted gross income for 1982?

a. $0
b. $12,000
c. $20,000
d. $32,000

54. Henry Mitchell is a self-employed individual. During 1982 his car, which he used 75% for business and 25% for personal use, was totally destroyed in an accident. The car had a fair market value of $10,800 when destroyed, which was less than the car's adjusted basis. Mitchell received only $9,000 as a recovery from his insurance company. What amount can Mitchell utilize as a casualty loss in calculating excess itemized deductions for 1982?

a. $1,800
b. $ 450
c. $ 350
d. $0

55. Harold Thompson, a self-employed individual, had income transactions for 1979 (duly reported on his return filed in April 1980) as follows:

Gross receipts	$400,000
Less cost of goods sold and deductions	320,000
Net business income	80,000
Capital gains	36,000
Gross income	$116,000

In March 1983 Thompson discovers that he had inadvertently omitted some income on his 1979 return and retains Mann, CPA, to determine his position under the statute of limitations. Mann should advise Thompson that the six-year statute of limitations would apply to his 1979 return only if he omitted from gross income an amount in excess of

a. $ 20,000
b. $ 29,000
c. $100,000
d. $109,000

56. During 1982 Robert Moore, who is 50 years old and unmarried, maintained his home in which he and his widower father, age 75, resided. His father had $1,600 interest income from a savings account and also received $2,400 from social security during 1982. Robert provided 60% of his father's total support for 1982. What is Robert's filing status for 1982, and how many exemptions should he claim on his tax return?

a. Head of household and 2 exemptions.
b. Single and 2 exemptions.
c. Head of household and 1 exemption.
d. Single and 1 exemption.

57. During 1982 Mary Dunn provided 20% of her own support; the remaining 80% was provided by her three sons as follows:

Bill	15%
Jon	25%
Tom	40%
	80%

Assume that a multiple support agreement exists and that the brothers will sign multiple support declarations as required. Which of the brothers is eligible to claim the mother as a dependent for 1982?

a. None of the brothers.
b. Tom only.
c. Jon or Tom only.
d. Bill, Jon or Tom.

58. John and Mary Arnold are a childless, married couple who lived apart (alone in homes maintained by each) the entire year 1982. On December 31, 1982, they were legally separated under a decree of separate maintenance. Which of the following is the only filing status choice available to them when filing for 1982?

a. Single.
b. Head of household.
c. Married filing separate return.
d. Married filing joint return.

Items 59 and 60 are based on the following information:

On October 29, 1982, Laura Stone received corporate bonds as an inheritance from her uncle who died on April 8, 1982. Her uncle's adjusted basis in the bonds was $35,000. The fair market value of the bonds was $48,000 at date of death and $49,000 on October 29, 1982. The alternate valuation date was not elected. The estate received interest of $2,000 on June 1, 1982. Laura had adjusted gross income of $30,000 for 1982 before any consideration of her inheritance.

59. What is Laura's adjusted gross income for 1982?

a. $30,000
b. $32,000
c. $67,000
d. $78,000

60. What is Laura's basis in the inherited bonds?

a. $35,000
b. $37,000
c. $48,000
d. $49,000

Number 4 (Estimated time —— 45 to 55 minutes)

Number 4 consists of two unrelated parts.

Part a. From inception of operations to December 31, 1981, Harris Corporation provided for uncollectible accounts receivable under the allowance method: provisions were made monthly at 2% of credit sales; bad debts written off were charged to the allowance account; recoveries of bad debts previously written off were credited to the allowance account; and, no year-end adjustments to the allowance account were made. Harris's usual credit terms are net 30 days.

The balance in the allowance for doubtful accounts was $130,000 at January 1, 1982. During 1982 credit sales totaled $9,000,000, interim provisions for doubtful accounts were made at 2% of credit sales, $90,000 of bad debts were written off, and recoveries of accounts previously written off amounted to $15,000. Harris installed a computer facility in November 1982 and an aging of accounts receivable was prepared for the first time as of December 31, 1982. A summary of the aging is as follows:

Classification by month of sale	*Balance in each category*	*Estimated % uncollectible*
Nov-Dec 1982	$1,140,000	2%
Jul-Oct	600,000	10
Jan-June	400,000	25
Prior to 1/1/82	130,000	75
	$2,270,000	

Based on the review of collectibility of the account balances in the "prior to 1/1/82" aging category, additional receivables totaling $60,000 were written off as of December 31, 1982. Effective with the year ended December 31, 1982, Harris adopted a new accounting method for estimating the allowance for doubtful accounts at the amount indicated by the year-end aging analysis of accounts receivable.

Required:

1. Prepare a schedule analyzing the changes in the allowance for doubtful accounts for the year ended December 31, 1982. Show supporting computations in good form.

2. Prepare the journal entry for the year-end adjustment to the allowance for doubtful accounts balance as of December 31, 1982.

Part b. On January 1, 1981, Lucas Distributors, Inc., adopted the dollar value LIFO inventory method for income tax and external financial statements reporting purposes. However, Lucas continued to use the FIFO inventory method for internal accounting and management purposes. In applying the LIFO method Lucas uses internal conversion price indexes and the multiple-pools approach under which substantially identical inventory items are grouped into LIFO inventory pools. The following data were available for Inventory Pool No. 1, which is comprised of products A and B, for the two years following the adoption of LIFO:

	FIFO basis per records		
	Units	*Unit cost*	*Total cost*
Inventory, 1/1/81			
Product A	12,000	$30	$360,000
Product B	8,000	25	200,000
			$560,000
Inventory, 12/31/81			
Product A	17,000	35	$595,000
Product B	9,000	28	252,000
			$847,000
Inventory, 12/31/82			
Product A	13,000	40	$520,000
Product B	10,000	32	320,000
			$840,000

Required:

1. Prepare a schedule to compute the internal conversion price indexes for 1981 and 1982. Round indexes to two decimal places.

2. Prepare a schedule to compute the inventory amounts at December 31, 1981 and 1982, using the dollar value LIFO inventory method.

Number 5 (Estimated time —— 40 to 50 minutes)

Bryant Corporation was incorporated on December 1, 1981, and began operations one week later. Bryant is a nonpublic enterprise. Before closing the books for the fiscal year ended November 30, 1982, Bryant's controller prepared the following financial statements:

Bryant Corporation
BALANCE SHEET
November 30, 1982

Assets	
Current assets	
Cash	$ 150,000
Marketable securities, at cost	60,000
Accounts receivable	450,000
Less allowance for doubtful accounts	(59,000)
Inventories	430,000
Prepaid insurance	15,000
Total current assets	1,046,000
Property, plant & equipment	426,000
Less accumulated depreciation	(40,000)
Research & development costs	120,000
Total assets	$1,552,000

Liabilities & Stockholders' Equity	
Current liabilities	
Accounts payable & accrued expenses	$ 592,000
Income taxes payable	224,000
Total current liabilities	816,000
Stockholders' equity	
Common stock, $10 par value	400,000
Retained earnings	336,000
Total stockholders' equity	736,000
Total liabilities & stockholders' equity	$1,552,000

Bryant Corporation
STATEMENT OF INCOME
For the Year Ended November 30, 1982

Net sales	$2,950,000
Operating expenses	
Cost of sales	1,670,000
Selling & administrative	650,000
Depreciation	40,000
Research & development	30,000
	2,390,000
Income before income taxes	560,000
Provision for income taxes	224,000
Net income	$ 336,000

Bryant is in the process of negotiating a loan for expansion purposes and the bank has requested audited financial statements. During the course of the audit, the following additional information was obtained:

1. The investment portfolio consists of short-term investments in marketable equity securities with a total market valuation of $55,000 as of November 30, 1982.

2. Based on an aging of the accounts receivable as of November 30, 1982, it was estimated that $36,000 of the receivables will be uncollectible.

3. Inventories at November 30, 1982, did not include work-in-process inventory costing $12,000 sent to an outside processor on November 29, 1982.

4. A $3,000 insurance premium paid on November 30, 1982, on a policy expiring one year later was charged to insurance expense.

5. Bryant adopted a pension plan on June 1, 1982, for eligible employees to be administered by a trustee. Based upon actuarial computations, the first 12 months' normal pension plan cost was estimated at $45,000.

6. On June 1, 1982, a production machine purchased for $24,000 was charged to repairs and maintenance. Bryant depreciates machines of this type on the straight-line method over a five-year life, with no salvage value, for financial and tax purposes.

7. Research and development costs of $150,000 were incurred in the development of a patent which Bryant expects to be granted during the fiscal year ending November 30, 1983. Bryant initiated a five-year amortization of the $150,000 total cost during the fiscal year ended November 30, 1982.

8. During December 1982 a competitor company filed suit against Bryant for patent infringement claiming $200,000 in damages. Bryant's legal counsel believes that an unfavorable outcome is probable. A reasonable estimate of the court's award to the plaintiff is $50,000.

9. The 40% effective tax rate was determined to be appropriate for calculating the provision for income taxes for the fiscal year ended November 30, 1982. Ignore computation of deferred portion of income taxes.

Required:

Complete the tear-out worksheet to prepare a corrected balance sheet of Bryant Corporation as of November 30, 1982, and a corrected statement of income for the year ended November 30, 1982. Formal statements and journal entries are not required. Supporting computations should be in good form. Include the completed tear-out worksheet in the proper sequence and turn in with other answer sheets.

Uniform Certified Public
Accountant Examination
Accounting Practice — Part I
May 1983

Candidate's No. ____________
State ____________
Question No. 5 Page ____________

Bryant Corporation
Worksheet for Balance Sheet
and Income Statement
November 30, 1982

Balance Sheet	*Unadjusted Balance*	*Adjustments* Debit	*Adjustments* Credit	*Adjusted Balance*
Assets:				
Cash	$ 150,000			
Marketable securities, at cost	60,000			
Accounts receivable	450,000			
Allowance for doubtful accounts	(59,000)			
Inventories	430,000			
Prepaid insurance	15,000			
Property, plant & equipment	426,000			
Accumulated depreciation	(40,000)			
Research & development costs	120,000			
	$1,552,000			
Liabilities & Stockholders' Equity:				
Accounts payable & accrued expenses	$ (592,000)			
Income taxes payable	(224,000)			
Common stock	(400,000)			
Retained earnings	(336,000)			
	$(1,552,000)			
Statement of Income				
Net sales	$(2,950,000)			
Cost of sales	1,670,000			
Selling & administrative expenses	650,000			
Depreciation expense	40,000			
Research & development expense	30,000			
Provision for income taxes	224,000			
Net income	$ (336,000)			

Uniform Certified Public Accountant Examination

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN ACCOUNTING PRACTICE — PART II

May 5, 1983; 1:30 to 6:00 P.M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* Minimum	*Estimated Minutes* Maximum
No. 1	45	55
No. 2	45	55
No. 3	45	55
No. 4	45	55
No. 5	40	50
Total	220	270

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers. Since objective items are computer-graded, your comments and calculations associated with them are not considered.

3. For problem-type questions you should enclose all scratch sheets. Failure to enclose scratch sheets may result in loss of grading points. Scratch sheets need not have page numbers, but you should show the question number and place them immediately following the question to which they relate.

4. Fourteen-column sheets, if any, should not be folded until all sheets, both wide and narrow, are placed in the proper sequence and fastened together at the top left corner. All fourteen-column sheets should then be wrapped around the back of the papers.

5. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of financial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

97. Gross billings for merchandise sold by Baker Company to its customers last year amounted to $5,260,000; sales returns and allowances reduced the amounts owed by $160,000. How much were net sales last year for Baker Company?
   a. $4,800,000
   b. $5,100,000
   c. $5,200,000
   d. $5,260,000

Answer Sheet

97. ⓐ ● ⓒ ⓓ

Items to be Answered

1. On September 1, 1982, Sol, Inc., exchanged 2,000 shares of its $25 par value common stock held in treasury, for a parcel of land to be held for a future plant site. The treasury shares were acquired by Sol at a cost of $60 per share. Sol's common stock had a fair market value of $80 per share on September 1, 1982. Sol received $9,000 from the sale of scrap when an existing building on the site was razed. The land should be carried at
   a. $111,000
   b. $120,000
   c. $151,000
   d. $160,000

2. On September 1, 1982, Bertz, Inc., exchanged a delivery truck for a parcel of land. Bertz bought this truck in 1980 for $10,000. At September 1, 1982, the truck had a book value of $6,500 and a fair market value of $5,000. Bertz gave $6,000 in cash in addition to the truck as part of this transaction. The previous owner of the land had listed the land for sale at $12,000. At what amount should Bertz record the land?
   a. $11,000
   b. $11,500
   c. $12,000
   d. $12,500

Items 3 and 4 are based on the following information:

The following condensed balance sheet is presented for the partnership of Bond, Whit, and Tell, who share profits and losses in the ratio of 5:3:2 respectively:

Cash	$120,000
Other assets	600,000
Total assets	$720,000
Liabilities	$240,000
Bond, Capital	300,000
Whit, Capital	160,000
Tell, Capital	20,000
Total liabilities and capital	$720,000

3. Assume that the assets and liabilities are fairly valued on the balance sheet, and that the partnership decided to admit Eller as a new partner with a one-fifth interest. No goodwill or bonus is to be recorded. How much should Eller contribute?
   a. $144,000
   b. $120,000
   c. $ 96,000
   d. $ 76,800

4. Assume that instead of admitting a new partner, the partners decided to liquidate the partnership. If the other assets are sold for $460,000, how much of the available cash should be distributed to Bond?
   a. $300,000
   b. $230,000
   c. $226,000
   d. $225,000

---

5. During 1983, Olsen Company discovered that the ending inventories reported on its financial statements were understated as follows:

Year	*Understatement*
1980	$50,000
1981	$60,000
1982	$0

Olsen ascertains year-end quantities on a periodic inventory system. These quantities are converted to dollar amounts using the FIFO cost flow method. Assuming no other accounting errors, Olsen's retained earnings at December 31, 1982, will be
   a. Correct.
   b. $ 60,000 understated.
   c. $ 60,000 overstated.
   d. $110,000 understated.

Items 6 and 7 are based on the following information:

Stevenson Corporation adopted a pension plan in 1981 on a funded, noncontributory basis. Stevenson elected to amortize past service cost over twelve years and to fund past service cost over ten years. Normal cost is to be funded as incurred each year. The following schedule reflects both amortization of past service cost and funding for the years 1982 and 1981:

	1982	*1981*
12-year amortization	$100,000	$100,000
Reduction for interest	1,155	—
Past service cost	98,845	100,000
10-year funding	109,628	109,628
Balance sheet—deferred charge:		
Balance	20,411	9,628
Increase	10,783	9,628

6. If normal cost for 1981 was $90,000, how much pension expense should Stevenson record for 1981?
   a. $ 90,000
   b. $109,628
   c. $190,000
   d. $199,628

7. If normal cost in 1982 was $95,000, what entry should Stevenson make in 1982 to record pension expense and funding?

		Debit	*Credit*
a.	Pension expense	$100,000	
	Deferred charge—funding in excess of cost	9,628	
	Cash		$109,628
b.	Pension expense	$193,845	
	Deferred charge—funding in excess of cost	10,783	
	Cash		$204,628
c.	Pension expense	$195,000	
	Deferred charge—funding in excess of cost	9,628	
	Cash		$204,628
d.	Pension expense	$195,000	
	Deferred charge—funding in excess of cost	10,783	
	Cash		$205,783

8. On March 1, 1982, a suit was filed against Dean Company for patent infringement. Dean's legal counsel believes an unfavorable outcome is probable, and estimates that Dean will have to pay between $500,000 and $900,000 in damages. However, Dean's legal counsel is of the opinion that $600,000 is a better estimate than any other amount in the range. The situation was unchanged when the December 31, 1982, financial statements were released on February 24, 1983. How much of a liability should Dean report on its balance sheet at December 31, 1982, in connection with this suit?
   a. $0
   b. $500,000
   c. $600,000
   d. $900,000

9. Empire Corporation owns an office building and leases the offices under a variety of rental agreements involving rent paid monthly in advance and rent paid annually in advance. Not all tenants make timely payments of their rent. Empire's balance sheets contained the following information:

	1982	*1981*
Rentals receivable	$3,100	$2,400
Unearned rentals	6,000	8,000

During 1982, Empire received $20,000 cash from tenants. How much rental revenue should Empire record for 1982?
   a. $17,300
   b. $18,700
   c. $21,300
   d. $22,700

10. Denso Corporation reports on a calendar-year basis. Its December 31, 1982, financial statements were issued on February 3, 1983. The auditor's report was dated January 22, 1983. The following information pertains to Denso's aggregate marketable equity securities portfolio:

Cost	$500,000
Market value, 12/31/82	400,000
Market value, 1/22/83	350,000
Market value, 2/3/83	300,000

How much should be reported on Denso's balance sheet at December 31, 1982, for marketable equity securities?
   a. $500,000
   b. $400,000
   c. $350,000
   d. $300,000

11. Luca and Mira formed a partnership on July 1, 1982, and contributed the following assets:

	Luca	*Mira*
Cash	$65,000	$100,000
Realty		300,000

The realty was subject to a mortgage of $25,000, which was assumed by the partnership. The partnership agreement provides that Luca and Mira will share profits and losses in the ratio of one-third and two-thirds respectively. Mira's capital account at July 1, 1982, should be

a. $400,000
b. $391,667
c. $375,000
d. $310,000

12. Following is the condensed balance sheet of Fine Products, an individual proprietorship, at December 31, 1982:

Current assets	$100,000
Equipment	200,000
Accumulated depreciation	(120,000)
	$180,000
Liabilities	$ 40,000
Silvia Fine, Capital	140,000
	$180,000

Fair market values of assets at December 31, 1982, were as follows:

Current assets	$110,000
Equipment	290,000

The liabilities were fairly stated at book values. On January 2, 1983, the proprietorship was incorporated, with 2,000 shares of $20 par value common stock issued. How much should be credited to additional paid-in capital?

a. $100,000
b. $140,000
c. $320,000
d. $360,000

13. Lucro Company pays a general manager's bonus based on 10% of Lucro's income after deducting the bonus but before deducting income taxes. For the year ended December 31, 1982, Lucro's income was $110,000 before deducting the bonus and income taxes. Lucro estimated its income tax expense at $40,000 for 1982. How much bonus should Lucro pay the general manager for 1982?

a. $0
b. $ 7,000
c. $10,000
d. $11,000

14. Herr, Inc., has a fiscal year ending April 30. On May 1, 1982, Herr borrowed $10,000,000 at 15% to finance construction of its own building. Repayments of the loan are to commence the month following completion of the building. During the year ended April 30, 1983, expenditures for the partially completed structure totaled $6,000,000. These expenditures were incurred evenly throughout the year. Interest earned on the unexpended portion of the loan amounted to $400,000 for the year. How much should be shown as capitalized interest on Herr's financial statements at April 30, 1983?

a. $0
b. $ 50,000
c. $ 450,000
d. $1,100,000

15. Loy Corp. purchased a machine in 1980 when the average Consumer Price Index (CPI) was 180. The average CPI was 190 for 1981, and 200 for 1982. Loy prepares supplementary constant dollar statements (adjusted for changing prices). Depreciation on this machine is $200,000 a year. In Loy's supplementary constant dollar statement for 1982, the amount of depreciation expense should be stated as

a. $180,000
b. $190,000
c. $210,526
d. $222,222

16. On July 1, 1982, Seco Company sold machinery to an unaffiliated company for its fair value of $275,000. Simultaneously, Seco leased back the machinery at $750 per month for five years, with no option to renew the lease or to repurchase the machinery. At July 1, 1982, this machinery had a book value of $250,000 and a remaining useful life of ten years. Seco's rent expense for this machinery for the year ended December 31, 1982, should be

a. $0
b. $2,000
c. $2,500
d. $4,500

17. Ross Corporation expects to sustain an operating loss of $100,000 for the full year ending December 31, 1983. Ross operates entirely in one jurisdiction where the tax rate is 40%. Anticipated tax credits for 1983 total $10,000. No permanent differences are expected. Realization of the full tax benefit of the expected operating loss and realization of anticipated tax credits are assured beyond any reasonable doubt because they will be carried back. For the first quarter ended March 31, 1983, Ross reported an operating loss of $20,000. How much of a tax benefit should Ross report for the interim period ended March 31, 1983?

a. $0
b. $ 8,000
c. $10,000
d. $12,500

18. Palo Corporation incurred the following losses, net of applicable taxes, for the year ended December 31, 1982:

- Loss on disposal of a segment of Palo's business $400,000
- Loss on translation of foreign currency due to major devaluation 500,000

How much should Palo report as extraordinary losses on its 1982 income statement?
a. $0
b. $400,000
c. $500,000
d. $900,000

19. On January 1, 1979, Cabal Company bought a machine for $1,500,000. At January 1, 1979, this machine had an estimated useful life of six years, with no salvage value. Cabal uses straight-line depreciation. As a result of additional information, Cabal determined on January 1, 1982, that the machine had an estimated useful life of eight years from the date it was acquired, with no salvage value. Accordingly, the appropriate accounting change was made in 1982. How much depreciation expense for this machine should Cabal record for the year ended December 31, 1982?
a. $125,000
b. $150,000
c. $187,500
d. $250,000

20. On June 4, 1982, Xmar Corporation sold $200,000 face amount of 12% bonds for $198,000, with interest payable semiannually beginning December 3, 1982. Each $1,000 bond had ten detachable warrants entitling the holder to buy one share of Xmar's common stock for each warrant surrendered, plus $20 cash. Shortly after the bonds were sold, each bond was selling for $1,000 without the warrants, while the warrants were selling for $10 each. What portion of the $198,000 proceeds should be credited to "Additional paid-in capital — warrants"?
a. $0
b. $ 2,000
c. $18,000
d. $20,000

Number 2 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of financial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

Items 21 and 22 are based on the following information:

On January 2, 1982, Doe Company leased a new crane from Leasement Corp. under the following terms:

- Noncancellable for eight years
- Annual lease payments of $10,000 beginning January 2, 1982, through January 2, 1989
- Nonrenewable
- Crane to be returned to Leasement on January 2, 1990

Doe properly recorded the crane as a "Leased asset — crane" in the amount of $52,880, based on a 14% interest rate implicit in the lease. Leasement paid $56,000 for the crane on December 31, 1981. The crane has an estimated useful life of ten years, with no salvage value. Both Doe and Leasement use the straight-line method of depreciation.

21. How much depreciation expense should Doe record in 1982 for "Leased asset — crane"?
a. $0
b. $ 6,610
c. $ 7,000
d. $10,000

22. How much interest income should Leasement recognize in 1982?
a. $10,000
b. $ 7,403
c. $ 6,003
d. $0

23. On June 18, 1982, Paul Printing Company incurred the following costs for one of its printing presses:

Purchase of collating and stapling attachment	$42,000
Installation of attachment	18,000
Replacement parts for overhaul of press	13,000
Labor and overhead in connection with overhaul	7,000
Total	$80,000

The overhaul resulted in a significant increase in production. Neither the attachment nor the overhaul increased the estimated useful life of the press. How much of the above costs should be capitalized?
a. $42,000
b. $55,000
c. $60,000
d. $80,000

Items 24 through 30 are based on the following information:

Best Corporation
BALANCE SHEETS

	December 31, 1982	December 31, 1981
Assets		
Current assets:		
Cash	$ 480,000	$ 220,000
Accounts receivable —net	840,000	560,000
Merchandise inventory	760,000	470,000
Total current assets	2,080,000	1,250,000
Land, buildings, and fixtures	1,330,000	800,000
Less accumulated depreciation	210,000	150,000
	1,120,000	650,000
Total assets	$3,200,000	$1,900,000
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 830,000	$ 440,000
Accrued expenses	300,000	130,000
Dividends payable	40,000	—
Total current liabilities	1,170,000	570,000
Stockholders' equity:		
Common stock ($10 par value)	1,200,000	900,000
Additional paid-in capital	200,000	100,000
Retained earnings	630,000	330,000
	2,030,000	1,330,000
Total liabilities and stockholders' equity	$3,200,000	$1,900,000

Best Corporation
INCOME STATEMENTS

	Year ended December 31, 1982	Year ended December 31, 1981
Credit sales	$6,300,000	$4,000,000
Cost of goods sold	4,900,000	3,200,000
Gross profit	1,400,000	800,000
Expenses (including income taxes)	700,000	630,000
Net income	$ 700,000	$ 170,000

Best Corporation
CHANGES IN STOCKHOLDERS' EQUITY

	Year ended December 31, 1982	Year ended December 31, 1981
Common stock		
Balance, 1/1	$ 900,000	$900,000
Sold, 4/1/82	100,000	—
20% stock dividend, 6/1/82	200,000	—
Balance, 12/31	$1,200,000	$900,000
Additional paid-in capital		
Balance, 1/1	$ 100,000	$100,000
Sold, 4/1/82	25,000	—
20% stock dividend, 6/1/82	75,000	—
Balance, 12/31	$ 200,000	$100,000
Retained earnings		
Balance, 1/1	$ 330,000	$250,000
Net income	700,000	170,000
Cash dividends	(125,000)	(90,000)
Stock dividends	(275,000)	—
Balance, 12/31	$ 630,000	$330,000

Additional available information included the following:

- Although Best will report all changes in financial position, management has adopted a format emphasizing the flow of working capital.

- During 1982, Best sold, at a $10,000 loss, fixtures with a book value of $30,000 ($100,000 cost minus $70,000 accumulated depreciation). This loss was included in the income statement. Depreciation expense for 1982 was $130,000. Best purchased $630,000 of new fixtures during 1982.

- Common stock issued during 1982 was as follows:

Date	*Number of shares*
4/1/82	10,000
6/1/82	20,000

24. How much working capital provided by operations during 1982 should be reported in the statement of changes in financial position?
   a. $300,000
   b. $700,000
   c. $830,000
   d. $840,000

25. How much working capital was provided by the sale of common stock during 1982?
  a. $100,000
  b. $125,000
  c. $200,000
  d. $400,000

26. How much working capital was used for dividends during 1982?
  a. $ 85,000
  b. $125,000
  c. $325,000
  d. $400,000

27. What is the weighted average number of shares that should be used for Best's computation of 1982 earnings per share?
  a. 109,167
  b. 117,000
  c. 117,500
  d. 120,000

28. Best's current ratio at December 31, 1982, is
  a. 0.56
  b. 0.89
  c. 1.13
  d. 1.78

29. Best's 1982 accounts receivable turnover is
  a. 5.83
  b. 7.00
  c. 7.50
  d. 9.00

30. Best debited retained earnings on June 1, 1982, for the market value of the stock dividend. The market value per share of Best's common stock on June 1, 1982, was
  a. $10.00
  b. $13.75
  c. $25.00
  d. $30.00

Items 31 through 33 are based on the following information:

Vorst Corporation's schedule of depreciable assets at December 31, 1981, was as follows:

Asset	*Cost*	*Accumulated depreciation*	*Acquisition date*	*Salvage value*
A	$100,000	$ 64,000	1980	$20,000
B	55,000	36,000	1979	10,000
C	70,000	33,600	1979	14,000
	$225,000	$133,600		$44,000

Vorst takes a full year's depreciation expense in the year of an asset's acquisition, and no depreciation expense in the year of an asset's disposition. The estimated useful life of each depreciable asset is five years.

31. Vorst depreciates asset A on the double-declining-balance method. How much depreciation expense should Vorst record in 1982 for asset A?
  a. $32,000
  b. $25,600
  c. $14,400
  d. $ 6,400

32. Using the same depreciation method as used in 1979, 1980, and 1981, how much depreciation expense should Vorst record in 1982 for asset B?
  a. $ 6,000
  b. $ 9,000
  c. $11,000
  d. $12,000

33. Vorst depreciates asset C by the straight-line method. On June 30, 1982, Vorst sold asset C for $28,000 cash. How much gain or (loss) should Vorst record in 1982 on the disposal of asset C?
  a. $2,800
  b. ($2,800)
  c. ($5,600)
  d. ($8,400)

---

34. The stockholders' equity section of Peter Corporation's balance sheet at December 31, 1982, was as follows:

Common stock ($10 par value, authorized 1,000,000 shares, issued and outstanding 900,000 shares)	$ 9,000,000
Additional paid-in capital	2,700,000
Retained earnings	1,300,000
Total stockholders' equity	$13,000,000

On January 2, 1983, Peter purchased and retired 100,000 shares of its stock for $1,800,000. Immediately after retirement of these 100,000 shares, the balances in the additional paid-in capital and retained earnings accounts should be

	Additional paid-in capital	*Retained earnings*
a.	$ 900,000	$1,300,000
b.	$1,400,000	$ 800,000
c.	$1,900,000	$1,300,000
d.	$2,400,000	$ 800,000

35. Electro Corporation had an operating loss carryforward of $250,000 at December 31, 1981, for which the benefit was fully realized at the end of 1982, when the income tax rate was 40%. For the year ended December 31, 1982, the tax benefit of the $250,000 loss carryforward should be reported as
   a. An extraordinary item of $100,000.
   b. A $100,000 reduction of 1982 income tax expense.
   c. An extraordinary item of $150,000.
   d. A $150,000 reduction of 1982 income tax expense.

Items 36 and 37 are based on the following information:

Bee Corp. prepared the following reconciliation between book income and taxable income for the year ended December 31, 1982:

Income before income taxes, per books	$500,000
Taxable income, per Form 1120	300,000
Difference	$200,000
Permanent difference — interest on municipal bonds	$ 50,000
Timing difference — lower depreciation per books	150,000
Total differences	$200,000

Bee's effective income tax rate for 1982 is 40%.
Bee reported the following information in its annual report:

Income before income taxes		$500,000
Provision for income taxes:		
Current	$?	
Deferred	?	
Net income		$

36. What amount should Bee report as the current portion of its provision for income taxes?
   a. $120,000
   b. $140,000
   c. $180,000
   d. $200,000

37. What amount should Bee report as the deferred portion of its provision for income taxes?
   a. $ 20,000
   b. $ 60,000
   c. $ 80,000
   d. $120,000

Items 38 through 40 are based on the following information:

The general ledger of Rosson Corporation showed the following investments at January 1, 1982:

Common stock:	
Joyce Corp. (2,000 shares)	$ 100,000
James Corp. (8,000 shares)	400,000
Real estate:	
Vacant lot #4 (leased to Whit Corp.)	1,000,000
Other:	
Textbook, *Ancient Accounting* (original preparation and printing costs)	80,000
Total investments	$1,580,000

Rosson owns 2% of Joyce and 30% of James. A majority of Rosson's directors are also directors of James. The Whit lease is for ten years, starting December 31, 1980, at an annual rental of $60,000. In addition, Whit paid a nonrefundable rental deposit of $100,000 on December 31, 1980, as well as a security deposit of $50,000 to be refunded upon expiration of the lease. *Ancient Accounting,* a textbook written by Rosson's personnel in 1979, was sold to Endless Hall, Inc., for royalties of 20% of sales. Royalties are payable semiannually on April 30 (for sales in July through December of the previous year) and on October 31 (for sales in January through June of the same year).

During the year ended December 31, 1982, Rosson received cash dividends of $2,000 from Joyce and $24,000 from James, whose 1982 net incomes were $80,000 and $200,000 respectively. Rosson also received $60,000 of rent from Whit in 1982, and the following royalty checks from Endless:

	April 30	*October 31*
1981	$12,000	$15,000
1982	10,000	13,000

Endless estimated that sales of *Ancient Accounting* would total $70,000 for the last half of 1982.

38. How much dividend income should Rosson report in its 1982 income statement?
   a. $0
   b. $ 2,000
   c. $26,000
   d. $61,600

---

39. How much rental revenue should Rosson report in its 1982 income statement?
   a. $0
   b. $60,000
   c. $70,000
   d. $75,000

40. How much royalty revenue should Rosson report in its 1982 income statement?
   a. $23,000
   b. $25,000
   c. $26,000
   d. $27,000

Number 3 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **the federal income taxation of corporations and partnerships.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **The answers should be based upon 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. Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

41. Hedge Holding Corporation has 100 unrelated stockholders, each of whom owns 100 shares of Hedge stock. For the year ended December 31, 1982, Hedge's adjusted gross income consisted of the following:

Dividends from domestic taxable corporations	$20,000
Interest earned on U.S. Treasury notes	12,000
Net rental income	6,000

Deductible expenses for 1982 totaled $8,000. Hedge paid no dividends in 1982. Hedge's liability for personal holding company tax for 1982 will be based on undistributed personal holding company income of
   a. $0
   b. $ 7,000
   c. $13,000
   d. $30,000

42. The minimum accumulated earnings credit beginning in 1982 is
   a. $150,000 for all corporations.
   b. $150,000 for nonservice corporations only.
   c. $250,000 for all corporations.
   d. $250,000 for nonservice corporations only.

43. During 1983 Wyld Corp., in need of additional factory space, exchanged 10,000 shares of its common stock with a par value of $50,000 for a building with a fair market value of $60,000. On the date of the exchange the stock had a fair market value of $65,000. For 1983, how much and what type of gain or loss should Wyld report on this transaction?
   a. $10,000 section 1231 gain.
   b. $10,000 capital gain.
   c. $ 5,000 capital loss.
   d. No gain or loss.

44. Lonky Corporation's condensed income statement for the year ended December 31, 1982, was as follows:

Business income	$500,000
Business costs and expenses	475,000
Operating income	$ 25,000
Charitable contributions	5,000
Income before income taxes	$ 20,000

The maximum amount deductible by Lonky for charitable contributions in its 1982 income tax return is
   a. $1,000
   b. $1,250
   c. $2,000
   d. $2,500

45. Finbury Corporation's taxable income for the year ended December 31, 1982, was $2,000,000, on which its tax liability was $900,250. In order for Finbury to escape the estimated tax underpayment penalty for the year ending December 31, 1983, Finbury's 1983 estimated tax payments must equal at least
   a. 60% of the 1983 tax liability.
   b. 65% of the 1983 tax liability.
   c. 75% of the 1983 tax liability.
   d. The 1982 tax liability of $900,250.

46. In 1982, Dr. Ernest Griffiths, a cash basis taxpayer, incorporated his medical practice. No liabilities were transferred. The following assets were transferred to the corporation:

Cash	$ 20,000
Equipment:	
Adjusted basis	140,000
Fair market value	180,000

Immediately after the transfer, Griffiths owned 100% of the corporation's stock. The corporation's total basis for the transferred assets is
   a. $140,000
   b. $160,000
   c. $180,000
   d. $200,000

47. Silva Corporation adopted a one-month complete liquidation plan on July 1, 1982, when Silva's accumulated earnings and profits were $30,000. John Blum, whose basis in Silva's stock was $15,000, was Silva's sole stockholder. On July 25, 1982, all of Silva's assets were distributed to Blum in exchange for Blum's stock. These assets comprised the following:

Cash	$22,500
Securities (fair market value)	37,500
Total	$60,000

How much should Blum report as dividend income in 1982?
   a. $0
   b. $22,500
   c. $30,000
   d. $45,000

48. Carmela Corporation had the following assets on January 2, 1982, the date on which it adopted a 12-month complete liquidation plan:

	Adjusted basis	*Fair market value*
Land	$ 75,000	$150,000
Inventory	43,500	66,000
Totals	$118,500	$216,000

The land was sold on June 30, 1982, to an unrelated party at a gain of $75,000. The inventory was sold to various customers during 1982 at an aggregate gain of $22,500. On December 10, 1982, the remaining asset (cash) was distributed to Carmela's stockholders, and the corporation was liquidated. What is Carmela's recognized gain in 1982?
   a. $0.
   b. $22,500 ordinary income.
   c. $75,000 capital gain.
   d. $97,500 capital gain.

49. Barbaro Corporation's retained earnings at January 1, 1982, was $600,000. During 1982 Barbaro paid cash dividends of $150,000 and received a federal income tax refund of $26,000 as a result of an IRS audit of Barbaro's 1979 tax return. Barbaro's net income per books for the year ended December 31, 1982, was $274,900 after deducting federal income tax of $183,300. How much should be shown in the reconciliation schedule M-2, of Form 1120, as Barbaro's retained earnings at December 31, 1982?
   a. $443,600
   b. $600,900
   c. $626,900
   d. $750,900

50. The following assets were among those owned by Yolanda Corporation at December 31, 1982:

Delivery truck	$12,000
Land used as parking lot for customers	20,000

The capital assets amount to
   a. $0
   b. $12,000
   c. $20,000
   d. $32,000

51. For the year ended December 31, 1982, Harlan, Inc., a Subchapter S corporation, had net income per books of $108,000, which included $90,000 from operations and an $18,000 net long-term capital gain. During 1982, $45,000 was distributed to Harlan's three equal shareholders, all of whom are on a calendar-year basis. On what amounts should Harlan compute its income and capital gain taxes?

	Ordinary income	*Long-term capital gain*
a.	$0	$0
b.	$0	$18,000
c.	$45,000	$0
d.	$63,000	$0

52. Claudio Corporation and Stellar Corporation both report on a calendar-year basis. Claudio merged into Stellar on June 30, 1982. Claudio had an allowable net operating loss carryover of $270,000. Stellar's taxable income for the year ended December 31, 1982, was $360,000 before consideration of Claudio's net operating loss carryover. How much of Claudio's net operating loss carryover can be used to offset Stellar's 1982 taxable income?
   a. $0
   b. $135,000
   c. $180,000
   d. $270,000

53. On June 30, 1982, James Roe sold his interest in the calendar-year partnership of Roe & Doe for $30,000. Roe's adjusted basis in Roe & Doe at June 30, 1982, was $7,500 before apportionment of any 1982 partnership income. Roe's distributive share of partnership income up to June 30, 1982, was $22,500. Roe acquired his interest in the partnership in 1970. How much long-term capital gain should Roe report in 1982 on the sale of his partnership interest?
   a. $0
   b. $15,000
   c. $22,500
   d. $30,000

54. Fred Elk's adjusted basis of his partnership interest in Arias & Nido was $30,000. Elk received a current nonliquidating distribution of $12,000 cash, plus property with a fair market value of $26,000 and an adjusted basis to the partnership of $24,000. How much is Elk's basis for the distributed property?

a. $18,000
b. $24,000
c. $26,000
d. $30,000

55. Daly & Shaw, a partnership, has an H.R. 10 plan. Daly's interest in the partnership is 95%, while Shaw's interest in the partnership is 5%. During 1982, Daly borrowed $3,800 from the plan, and Shaw borrowed $200 from the plan. How much of these loans will be automatically treated by the Internal Revenue Service as distributions from the plan?

a. $0
b. $ 200
c. $3,800
d. $4,000

56. Axel, Banner & Carr, a calendar-year partnership, had the following partners since 1970:

	Partnership interest (%)
Axel	20
Banner	20
Carr	60

On October 20, 1982, Axel and Banner sold their partnership interests to Carr and withdrew from participation in the partnership's affairs. At what date was the partnership terminated for tax purposes?

a. October 1, 1982.
b. October 20, 1982.
c. October 31, 1982.
d. December 31, 1982.

57. David Beck and Walter Crocker were equal partners in the calendar-year partnership of Beck & Crocker. On July 1, 1982, Beck died. Beck's estate became the successor in interest and continued to share in Beck & Crocker's profits until Beck's entire partnership interest was liquidated on April 30, 1983. At what date was the partnership considered terminated for tax purposes?

a. April 30, 1983.
b. December 31, 1982.
c. July 31, 1982.
d. July 1, 1982.

58. On July 1, 1982, Clark acquired a 20% interest in the partnership of Davis & Denny, by contributing a parcel of land for which his basis was $8,000. At July 1, 1982, the land had a fair market value of $20,000 and was subject to a mortgage of $4,000. Payment of the mortgage was assumed by the partnership. The basis of Clark's interest in the partnership is

a. $ 4,000
b. $ 4,800
c. $16,000
d. $16,800

59. At December 31, 1982, Max Curcio's adjusted basis in the partnership of Maduro & Motta was $36,000. On December 31, 1982, Maduro & Motta distributed cash of $6,000 and a parcel of land to Curcio in liquidation of Curcio's entire interest in the partnership. The land had an adjusted basis of $18,000 to the partnership and a fair market value of $42,000 at December 31, 1982. How much is Curcio's basis in the land?

a. $0
b. $12,000
c. $30,000
d. $36,000

60. John Albin is a retired partner of Brill & Crum, a personal service partnership. Albin has not rendered any services to Brill & Crum since his retirement in 1975. Under the provisions of Albin's retirement agreement, Brill & Crum is obligated to pay Albin 10% of the partnership's net income each year. In compliance with this agreement, Brill & Crum paid Albin $25,000 in 1982. How should Albin treat this $25,000?

a. Not taxable.
b. Ordinary income.
c. Short-term capital gain.
d. Long-term capital gain.

Number 4 (Estimated time —— 45 to 55 minutes)

Melford Hospital operates a general hospital, but rents space and beds to separately owned entities rendering specialized services such as pediatrics and psychiatric. Melford charges each separate entity for common services such as patients' meals and laundry, and for administrative services such as billings and collections. Space and bed rentals are fixed charges for the year, based on bed capacity rented to each entity.

Melford charged the following costs to pediatrics for the year ended June 30, 1982:

	Patient days (Variable)	*Bed capacity (Fixed)*
Dietary	$ 600,000	—
Janitorial	—	$ 70,000
Laundry	300,000	—
Laboratory	450,000	—
Pharmacy	350,000	—
Repairs and maintenance	—	30,000
General and administrative	—	1,300,000
Rent	—	1,500,000
Billings and collections	300,000	—
Totals	$2,000,000	$2,900,000

During the year ended June 30, 1982, pediatrics charged each patient an average of $300 per day, had a capacity of 60 beds, and had revenue of $6,000,000 for 365 days.

In addition, pediatrics directly employed the following personnel:

	Annual salaries
Supervising nurses	$25,000
Nurses	20,000
Aides	9,000

Melford has the following minimum departmental personnel requirements based on total annual patient days:

Annual patient days	*Aides*	*Nurses*	*Supervising nurses*
Up to 21,900	20	10	4
21,901 to 26,000	26	13	4
26,001 to 29,200	30	15	4

These staffing levels represent full-time equivalents. Pediatrics always employs only the minimum number of required full-time equivalent personnel. Salaries of supervising nurses, nurses, and aides are therefore fixed within ranges of annual patient days.

Pediatrics operated at 100% capacity on 90 days during the year ended June 30, 1982. It is estimated that during these 90 days the demand exceeded 20 patients more than capacity. Melford has an additional 20 beds available for rent for the year ending June 30, 1983. Such additional rental would increase pediatrics' fixed charges based on bed capacity.

Required:

a. Calculate the minimum number of patient days required for pediatrics to break even for the year ending June 30, 1983, if the additional 20 beds are not rented. Patient demand is unknown, but assume that revenue per patient day, cost per patient day, cost per bed, and salary rates will remain the same as for the year ended June 30, 1982.

b. Assume that patient demand, revenue per patient day, cost per patient day, cost per bed, and salary rates for the year ending June 30, 1983, remain the same as for the year ended June 30, 1982. Prepare a schedule of increase in revenue and increase in costs for the year ending June 30, 1983, in order to determine the net increase or decrease in earnings from the additional 20 beds if pediatrics rents this extra capacity from Melford.

Number 5 (Estimated time —— 40 to 50 minutes)

In 1950 a group of civic-minded merchants in Albury City organized the "Committee of 100" for the purpose of establishing the Community Sports Club, a nonprofit sports organization for local youth. Each of the Committee's 100 members contributed $1,000 towards the Club's capital, and in turn received a participation certificate. In addition, each participant agreed to pay dues of $200 a year for the Club's operations. All dues have been collected in full by the end of each fiscal year ending March 31. Members who have discontinued their participation have been replaced by an equal number of new members through transfer of the participation certificates from the former members to the new ones. Following is the Club's trial balance at April 1, 1982:

	Debit	*Credit*
Cash	$ 9,000	
Investments (at market, equal to cost)	58,000	
Inventories	5,000	
Land	10,000	
Building	164,000	
Accumulated depreciation—building		$130,000
Furniture and equipment	54,000	
Accumulated depreciation—furniture and equipment		46,000
Accounts payable		12,000
Participation certificates (100 at $1,000 each)		100,000
Cumulative excess of revenue over expenses		12,000
	$300,000	$300,000

Transactions for the year ended March 31, 1983, were as follows:

(1)	Collections from participants for dues	$20,000
(2)	Snack bar and soda fountain sales	28,000
(3)	Interest and dividends received	6,000
(4)	Additions to voucher register:	
	House expenses	17,000
	Snack bar and soda fountain	26,000
	General and administrative	11,000
(5)	Vouchers paid	55,000
(6)	Assessments for capital improvements not yet incurred (assessed on March 20, 1983; none collected by March 31, 1983; deemed 100% collectible during year ending March 31, 1984)	10,000
(7)	Unrestricted bequest received	5,000

Adjustment data:

(1) Investments are valued at market, which amounted to $65,000 at March 31, 1983. There were no investment transactions during the year.

(2) Depreciation for the year:

Building	$4,000
Furniture and equipment	8,000

(3) Allocation of depreciation:

House expenses	9,000
Snack bar and soda fountain	2,000
General and administrative	1,000

(4) Actual physical inventory at March 31, 1983, was $1,000, and pertains to the snack bar and soda fountain.

Required:

On a functional basis

a. Record the transactions and adjustments in journal entry form for the year ended March 31, 1983. Omit explanations.

b. Prepare the appropriate all-inclusive activity statement for the year ended March 31, 1983.

Uniform Certified Public Accountant Examination

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN AUDITING

May 5, 1983; 8:30 A.M. to 12:00 M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	90	110
No. 2	15	25
No. 3	15	25
No. 4	15	25
No. 5	15	25
Total	150	210

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers.

3. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 90 to 110 minutes)

Instructions

Select the **best** answer for each of the following items. Use a soft pencil, preferably No 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

96. One of the generally accepted auditing standards specifies that the auditor
   a. Inspect all fixed assets acquired during the year.
   b. Charge fair fees based on cost.
   c. Make a proper study and evaluation of the existing internal control.
   d. Count client petty cash funds.

Answer Sheet

96. ⓐ ⓑ ● ⓓ

Items to be Answered

1. In which of the following cases would the auditor be most likely to conclude that all of the items in an account under consideration should be examined rather than tested on a sample basis?

	The measure of tolerable error is	*Error frequency is expected to be*
a.	Large	Low
b.	Small	High
c.	Large	High
d.	Small	Low

2. The tolerable rate of deviations for a compliance test is generally
   a. Lower than the expected rate of errors in the related accounting records.
   b. Higher than the expected rate of errors in the related accounting records.
   c. Identical to the expected rate of errors in the related accounting records.
   d. Unrelated to the expected rate of errors in the related accounting records.

3. The procedures specifically outlined in an audit program are primarily designed to
   a. Protect the auditor in the event of litigation.
   b. Detect errors or irregularities.
   c. Test internal systems.
   d. Gather evidence.

4. An auditor would be most likely to consider expressing a qualified opinion or disclaimer of opinion if the client's financial statements include a footnote that
   a. Lists the amounts due from related parties including the terms and manner of settlement in routine transactions.
   b. Describes the influence which the client has over the other parties in certain transactions.
   c. Represents that certain transactions with related parties were consummated on terms equally as favorable as would have been obtained in transactions with unrelated parties.
   d. Presents the dollar volume of related party transactions and the effects of any change in the method of establishing terms from that of the prior period.

5. If the auditor is concerned that a population may contain exceptions, the determination of a sample size sufficient to include at **least** one such exception is a characteristic of
   a. Discovery sampling.
   b. Variables sampling.
   c. Random sampling.
   d. Dollar-unit sampling.

6. Which of the following best illustrates the concept of sampling risk?
   a. A randomly chosen sample may **not** be representative of the population as a whole on the characteristic of interest.
   b. An auditor may select audit procedures that are **not** appropriate to achieve the specific objective.
   c. An auditor may fail to recognize errors in the documents examined for the chosen sample.
   d. The documents related to the chosen sample may **not** be available for inspection.

7. An auditor plans to examine a sample of 20 checks for countersignatures as prescribed by the client's internal control procedures. One of the checks in the chosen sample of 20 cannot be found. The auditor should consider the reasons for this limitation and
   a. Evaluate the results as if the sample size had been 19.
   b. Treat the missing check as a deviation for the purpose of evaluating the sample.
   c. Treat the missing check in the same manner as the majority of the other 19 checks, i.e. countersigned or not.
   d. Choose another check to replace the missing check in the sample.

8. An auditor who finds that the client has committed an illegal act would be most likely to withdraw from the engagement when the
   a. Illegal act affects the auditor's ability to rely on management representations.
   b. Illegal act has material financial statement implications.
   c. Illegal act has received widespread publicity.
   d. Auditor can **not** reasonably estimate the effect of the illegal act on the financial statements.

9. When comparative financial statements are presented but the predecessor auditor's report is **not** presented, the current auditor should do which of the following in the audit report?
   a. Disclaim an opinion on the prior year's financial statements.
   b. Identify the predecessor auditor who examined the financial statements of the prior year.
   c. Make **no** comment with respect to the predecessor auditor's examination.
   d. Indicate the type of opinion expressed by the predecessor auditor.

10. When reporting on financial statements prepared on a comprehensive basis of accounting other than generally accepted accounting principles, the independent auditor should include in the report a paragraph that
   a. States that the financial statements are **not** intended to be in conformity with generally accepted accounting principles.
   b. Justifies the comprehensive basis of accounting being used.
   c. Refers to the authoritative pronouncements that explain the comprehensive basis of accounting being used.
   d. States that the financial statements are **not** intended to have been examined in accordance with generally accepted auditing standards.

11. The essence of the attest function is to
   a. Detect fraud.
   b. Examine individual transactions so that the auditor may certify as to their validity.
   c. Determine whether the client's financial statements are fairly stated.
   d. Assure the consistent application of correct accounting procedures.

12. Tracing copies of sales invoices to shipping documents will provide evidence that all
   a. Shipments to customers were recorded as receivables.
   b. Billed sales were shipped.
   c. Debits to the subsidiary accounts receivable ledger are for sales shipped.
   d. Shipments to customers were billed.

13. A lawyer limits a response concerning a litigated claim because the lawyer is unable to determine the likelihood of an unfavorable outcome. Which type of opinion should the auditor express if the litigation is adequately disclosed and the range of potential loss is material in relation to the client's financial statements considered as a whole?
   a. Adverse.
   b. Unaudited.
   c. Qualified.
   d. Unqualified.

14. The fourth reporting standard 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. The CPA from reporting on one basic financial statement and **not** the others.
   b. Misinterpretations regarding the degree of responsibility the auditor is assuming.
   c. The CPA from expressing different opinions on each of the basic financial statements.
   d. Management from reducing its final responsibility for the basic financial statements.

15. Which of the following is **not** a universal rule for achieving strong internal control over cash?
   a. Separate the cash handling and record-keeping functions.
   b. Decentralize the receiving of cash as much as possible.
   c. Deposit each day's cash receipts by the end of the day.
   d. Have bank reconciliations performed by employees independent with respect to handling cash.

16. A secondary objective of the auditor's study and evaluation of internal control is that the study and evaluation provide
   a. A basis for constructive suggestions concerning improvements in internal control.
   b. A basis for reliance on the system of internal accounting control.
   c. An assurance that the records and documents have been maintained in accordance with existing company policies and procedures.
   d. A basis for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.

17. Which of the following should be recognized as a consistency modification in the auditor's report, whether or **not** the item is fully disclosed in the financial statements?
    a. A change in accounting estimate.
    b. A change from an unacceptable accounting principle to a generally accepted one.
    c. Correction of an error **not** involving a change in accounting principle.
    d. A change in classification.

18. The AICPA Code of Professional Ethics states that a CPA shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client. This rule should be understood to preclude a CPA from responding to an inquiry made by
    a. The trial board of the AICPA.
    b. A CPA-shareholder of the client corporation.
    c. An investigative body of a state CPA society.
    d. An AICPA voluntary quality review body.

19. Each of the following might, in itself, form a valid basis for an auditor to decide to omit a test **except** the
    a. Relative risk involved.
    b. Relationship between the cost of obtaining evidence and its usefulness.
    c. Difficulty and expense involved in testing a particular item.
    d. Degree of reliance on the relevant internal controls.

20. Which of the following would be **least** likely to be considered an objective of a system of internal control?
    a. Checking the accuracy and reliability of accounting data.
    b. Detecting management fraud.
    c. Encouraging adherence to managerial policies.
    d. Safeguarding assets.

21. After a preliminary review of a client's EDP control, an auditor may decide not to perform compliance tests related to the control procedures within the EDP portion of the client's internal control system. Which of the following would **not** be a valid reason for choosing to omit compliance tests?
    a. The controls duplicate operative controls existing elsewhere in the system.
    b. There appear to be major weaknesses that would preclude reliance on the stated procedure.
    c. The time and dollar costs of testing exceed the time and dollar savings in substantive testing if the compliance tests show the controls to be operative.
    d. The controls appear adequate enough to be relied upon.

22. In general, a material internal control weakness may be defined as a condition in which material errors or irregularities would ordinarily **not** be detected within a timely period by
    a. An auditor during the normal study and evaluation of the system of internal control.
    b. A controller when reconciling accounts in the general ledger.
    c. Employees in the normal course of performing their assigned functions.
    d. The chief financial officer when reviewing interim financial statements.

23. Which of the following sets of duties would ordinarily be considered basically incompatible in terms of good internal control?
    a. Preparation of monthly statements to customers and maintenance of the accounts receivable subsidiary ledger.
    b. Posting to the general ledger and approval of additions and terminations relating to the payroll.
    c. Custody of unmailed signed checks and maintenance of expense subsidiary ledgers.
    d. Collection of receipts on account and maintaining accounts receivable records.

24. Assuming an excellent system of internal control exists, which of the following audit procedures would be **least** likely to be performed?
    a. Physical inspection of a sample of inventory.
    b. Search for unrecorded cash receipts.
    c. Obtain a client representation letter.
    d. Confirmation of accounts receivable.

25. A CPA who is **not** independent may issue a
    a. Review report.
    b. Comfort letter.
    c. Qualified opinion.
    d. Compilation report.

26. If the principal auditor decides to make reference to the other auditor's examination, the scope paragraph must specifically indicate the
    a. Magnitude of the portion of the financial statements examined by the other auditor.
    b. Name of the other auditor.
    c. Name of the consolidated subsidiary examined by the other auditor.
    d. Type of opinion expressed by the other auditor.

27. A closely-held manufacturing company must disclose all of the following information in audited financial statements **except**
    a. Replacement cost of inventory.
    b. Any pledged inventory.
    c. LIFO reserves.
    d. Any changes in methods of accounting for inventory.

28. When the client fails to include information that is necessary for the fair presentation of financial statements in the body of the statements or in the related footnotes, it is the responsibility of the auditor to present the information, if practicable, in the auditor's report and issue a(n)
    a. Qualified opinion or a disclaimer of opinion.
    b. Qualified opinion or an adverse opinion.
    c. Adverse opinion or a disclaimer of opinion.
    d. Qualified opinion or an unqualified opinion.

29. If a client makes a change in accounting principle that is inseparable from the effect of a change in estimate, this material event should be accounted for as a change in
    a. Estimate and the auditor would report a consistency exception.
    b. Principle and the auditor would report a consistency exception.
    c. Estimate and the auditor would **not** modify the report.
    d. Principle and the auditor would **not** modify the report.

30. When restrictions that significantly limit the scope of the audit are imposed by the client, the auditor generally should issue which of the following opinions?
    a. "Except for."
    b. Disclaimer.
    c. Adverse.
    d. "Subject to."

31. When an auditor performs a review of interim financial statements which of the following steps would **not** be part of the review?
    a. Review of computer controls.
    b. Inquiry of management.
    c. Review of ratios and trends.
    d. Reading the minutes of the stockholders' meetings.

32. An auditor reconciles the total of the accounts receivable subsidiary ledger to the general ledger control account, as of October 31, 1982. By this procedure, the auditor would be most likely to learn of which of the following?
    a. An October invoice was improperly computed.
    b. An October check from a customer was posted in error to the account of another customer with a similar name.
    c. An opening balance in a subsidiary ledger account was improperly carried forward from the previous accounting period.
    d. An account balance is past due and should be written off.

33. An auditor has accounted for a sequence of inventory tags and is now going to trace information on a representative number of tags to the physical inventory sheets. The purpose of this procedure is to obtain assurance that
    a. The final inventory is valued at cost.
    b. All inventory represented by an inventory tag is listed on the inventory sheets.
    c. All inventory represented by an inventory tag is bona fide.
    d. Inventory sheets do **not** include untagged inventory items.

34. A CPA establishes quality control policies and procedures for deciding whether to accept a new client or continue to perform services for a current client. The primary purpose for establishing such policies and procedures is
    a. To enable the auditor to attest to the integrity or reliability of a client.
    b. To comply with the quality control standards established by regulatory bodies.
    c. To lessen the exposure to litigation resulting from failure to detect irregularities in client financial statements.
    d. To minimize the likelihood of association with clients whose management lacks integrity.

35. When an on-line, real-time (OLRT) electronic data processing system is in use, internal control can be strengthened by
    a. Providing for the separation of duties between keypunching and error listing operations.
    b. Attaching plastic file protection rings to reels of magnetic tape before new data can be entered on the file.
    c. Making a validity check of an identification number before a user can obtain access to the computer files.
    d. Preparing batch totals to provide assurance that file updates are made for the entire input.

36. The physical count of inventory of a retailer was higher than shown by the perpetual records. Which of the following could explain the difference?
    a. Inventory items had been counted but the tags placed on the items had **not** been taken off the items and added to the inventory accumulation sheets.
    b. Credit memos for several items returned by customers had **not** been recorded.
    c. No journal entry had been made on the retailer's books for several items returned to its suppliers.
    d. An item purchased "FOB shipping point" had **not** arrived at the date of the inventory count and had **not** been reflected in the perpetual records.

37. A company has changed its method of inventory valuation from an unacceptable one to one in conformity with generally accepted accounting principles. The auditor's report on the financial statements of the year of the change should include
   a. No reference to consistency.
   b. A reference to a prior period adjustment.
   c. A middle paragraph explaining the change.
   d. A justification for making the change and the impact of the change on reported net income.

38. Which of the following auditing procedures is ordinarily performed last?
   a. Reading of the minutes of the directors' meetings.
   b. Confirming accounts payable.
   c. Obtaining a management representation letter.
   d. Testing of the purchasing function.

39. Which of the following would **not** be considered an internal control feature?
   a. Use of the double-entry system.
   b. An internal audit staff.
   c. Competent personnel.
   d. A comparison-shopping staff.

40. After finishing the review phase of the study and evaluation of internal control in an audit engagement, the auditor should perform compliance tests on
   a. Those controls that the auditor plans to rely upon.
   b. Those controls in which material weaknesses were identified.
   c. Those controls that have a material effect upon the financial-statement balances.
   d. A random sample of the controls that were reviewed.

41. In connection with the examination of financial statements by an independent auditor, the client suggests that members of the internal audit staff be utilized to minimize audit costs. Which of the following tasks could most appropriately be delegated to the internal audit staff?
   a. Selection of accounts receivable for confirmation, based upon the internal auditor's judgment as to how many accounts and which accounts will provide sufficient coverage.
   b. Preparation of schedules for negative accounts receivable responses.
   c. Evaluation of the internal control for accounts receivable and sales.
   d. Determination of the adequacy of the allowance for doubtful accounts.

42. For which of the following ledger accounts would the auditor be **most** likely to analyze the details?
   a. Service Revenue.
   b. Sales.
   c. Repairs and maintenance expense.
   d. Sales salaries expense.

43. During the current examination, an auditor who issued an unqualified report on the prior year's financial statements becomes aware of a material unresolved uncertainty that affects the prior year financial statements presented with the current year financial statements. The auditor should
   a. Qualify or disclaim an opinion in the updated report on the prior year's financial statements.
   b. Not change the opinion on the prior year's financial statements because the uncertainty remains unresolved.
   c. Express an adverse opinion in the updated report on the prior year's financial statements.
   d. Express an opinion only on the current year's financial statements.

44. In determining estimates of fees, an auditor may take into account each of the following, **except** the
   a. Value of the service to the client.
   b. Degree of responsibility assumed by undertaking the engagement.
   c. Skills required to perform the service.
   d. Attainment of specific findings.

45. Dickens, a CPA firm's personnel partner, periodically studies the CPA firm's personnel advancement experience to ascertain whether individuals meeting stated criteria are assigned increased degrees of responsibility. This is evidence of the CPA firm's adherence to prescribed
   a. Standards of due professional care.
   b. Quality control standards.
   c. Supervision and review standards.
   d. Standards of fieldwork.

46. Which of the following is ordinarily designed to detect possible material dollar errors on the financial statements?
   a. Compliance testing.
   b. Analytical review.
   c. Computer controls.
   d. Post audit working paper review.

47. If a control total were to be computed on each of the following data items, which would best be identified as a hash total for a payroll EDP application?
   a. Net pay.
   b. Department numbers.
   c. Hours worked.
   d. Total debits and total credits.

48. Generally, the decision to notify parties outside the client's organization regarding an illegal act is the responsibility of the
   a. Independent auditor.
   b. Management.
   c. Outside legal counsel.
   d. Internal auditors.

49. In which of the following instances would an auditor be **least** likely to require the assistance of a specialist?
   a. Assessing the valuation of inventories of art works.
   b. Determining the quantities of materials stored in piles on the ground.
   c. Determining the value of unlisted securities.
   d. Ascertaining the assessed valuation of fixed assets.

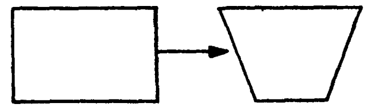
50. A client's physical count of inventories was higher than the inventory quantities per the perpetual records. This situation could be the result of the failure to record
   a. Sales.
   b. Sales discounts.
   c. Purchases.
   d. Purchase returns.

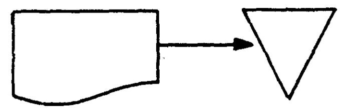
51. An attorney is responding to an independent auditor as a result of the audit client's letter of inquiry. The attorney may appropriately limit the response to
   a. Asserted claims and litigation.
   b. Matters to which the attorney has given substantive attention in the form of legal consultation or representation.
   c. Asserted, overtly threatened, or pending claims and litigation.
   d. Items which have an extremely high probability of being resolved to the client's detriment.

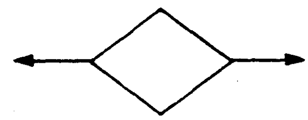
52. In violation of company policy, Lowell Company erroneously capitalized the cost of painting its warehouse. The auditor examining Lowell's financial statements would most likely detect this when
   a. Discussing capitalization policies with Lowell's controller.
   b. Examining maintenance expense accounts.
   c. Observing, during the physical inventory observation, that the warehouse had been painted.
   d. Examining the construction work orders supporting items capitalized during the year.

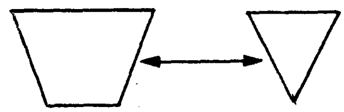
53. Governmental auditing often extends beyond examinations leading to the expression of opinion on the fairness of financial presentation and includes audits of efficiency, effectiveness, and
   a. Internal control.
   b. Evaluation.
   c. Accuracy.
   d. Compliance.

54. Which of the following symbolic representations indicate that a file has been consulted?

a. 

b. 

c. 

d. 

55. When the financial statements of a nonpublic entity for a prior period have **not** been audited and are presented, for comparative purposes, with current period statements that have been audited,
   a. The auditor should request removal of the unaudited statements since it is improper to present them for comparative purposes with audited statements.
   b. The auditor should identify the financial statements that were **not** examined in a separate paragraph in the auditor's report accompanying the current statements.
   c. The unaudited statements do **not** need to be marked "unaudited" as this may confuse the users of the statements.
   d. The auditor's report accompanying the statements should **not** mention that the prior period statements are unaudited, but the unaudited statements should be marked "unaudited."

56. A CPA should **not** undertake a management advisory service engagement that includes continued participation through implementation, unless
   a. The CPA accepts overall responsibility for implementation of the chosen course of action.
   b. The CPA acquires an overall knowledge of the client's business that is equivalent to that possessed by management.
   c. Upon implementation the client's personnel will have the knowledge and ability to adequately maintain and operate such systems as may be involved.
   d. Upon implementation a new study and evaluation of the system of internal control is performed.

57. Which of the following is **not** an element of quality control?
    a. Documentation.
    b. Inspection.
    c. Supervision.
    d. Consultation.

58. A CPA, while performing an audit, strives to achieve independence in appearance in order to
    a. Reduce risk and liability.
    b. Become independent in fact.
    c. Maintain public confidence in the profession.
    d. Comply with the generally accepted standards of fieldwork.

59. Proper segregation of functional responsibilities calls for separation of the
    a. Authorization, recording, and custodial functions.
    b. Authorization, execution, and payment functions.
    c. Receiving, shipping, and custodial functions.
    d. Authorization, approval, and execution functions.

60. Which of the following is an administrative control?
    a. Authorizing credit terms.
    b. Execution of transactions.
    c. Recording original data.
    d. Accountability over source data.

Number 2 (Estimated time —— 15 to 25 minutes)

During the examination of the annual financial statements of Amis Manufacturing, Inc., the company's president, R. Alderman, and Luddy, the auditor, reviewed matters that were supposed to be included in a written representation letter. Upon receipt of the following client representation letter, Luddy contacted Alderman to state that it was incomplete.

To E. K. Luddy, CPA

In connection with your examination of the balance sheet of Amis Manufacturing, Inc. as of December 31, 1982, and the related statements of income, retained earnings, and changes in financial position for the year then ended, for the purpose of expressing an opinion as to whether the financial statements present fairly the financial position, results of operations, and changes in financial position of Amis Manufacturing, Inc. in conformity with generally accepted accounting principles, we confirm, to the best of our knowledge and belief, the following representations made to you during your examination. There were no:

- Plans or intentions that may materially affect the carrying value or classification of assets and liabilities.

- Communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.

- Agreements to repurchase assets previously sold.

- Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.

- Unasserted claims or assessments that our lawyer has advised are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards No. 5.

- Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements.

- Compensating balance or other arrangements involving restrictions on cash balances.

R. Alderman, President
Amis Manufacturing, Inc.

March 14, 1983

Required:

Identify the other matters that Alderman's representation letter should specifically confirm.

Number 3 (Estimated time —— 15 to 25 minutes)

The following report was drafted by an audit assistant at the completion of an audit engagement and was submitted to the auditor with client responsibility for review. The auditor has reviewed matters thoroughly and has properly concluded that the scope limitation was not client-imposed and was not sufficiently material to warrant a disclaimer of opinion although a qualified opinion was appropriate.

To Carl Corporation Controller:

We have examined the accompanying financial statements of Carl Corporation as of December 31, 1982. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such auditing procedures as we considered necessary in the circumstances.

On January 15, 1983, the company issued debentures in the amount of $1,000,000 for the purpose of financing plant expansion. As indicated in note 6 to the financial statements, the debenture agreement restricts the payment of future cash dividends to earnings after December 31, 1982.

The company's unconsolidated foreign subsidiary did not close down production during the year under examination for physical inventory purposes and took no physical inventory during the year. We made extensive tests of book inventory figures for accuracy of calculation and reasonableness of pricing. We did not make physical tests of inventory quantities. Because of this, we are unable to express an unqualified opinion on the financial statements taken as a whole. However:

Except for the scope limitation regarding inventory, in our opinion the accompanying balance sheet presents the financial position of Carl Corporation at December 31, 1982, subject to the effect of the inventory on the carrying value of the investment. The accompanying statements of income and of retained earnings present the incomes and expenses and the result of transactions affecting retained earnings in accordance with generally accepted accounting principles.

December 31, 1982

Pate & Co., CPAs

Required:

Identify all of the deficiencies in the above draft of the proposed report.

Number 4 (Estimated time —— 15 to 25 minutes)

The following client-prepared bank reconciliation is being examined by Kautz, CPA, during an examination of the financial statements of Cynthia Company:

Cynthia Company
BANK RECONCILIATION
VILLAGE BANK ACCOUNT 2
December 31, 1982

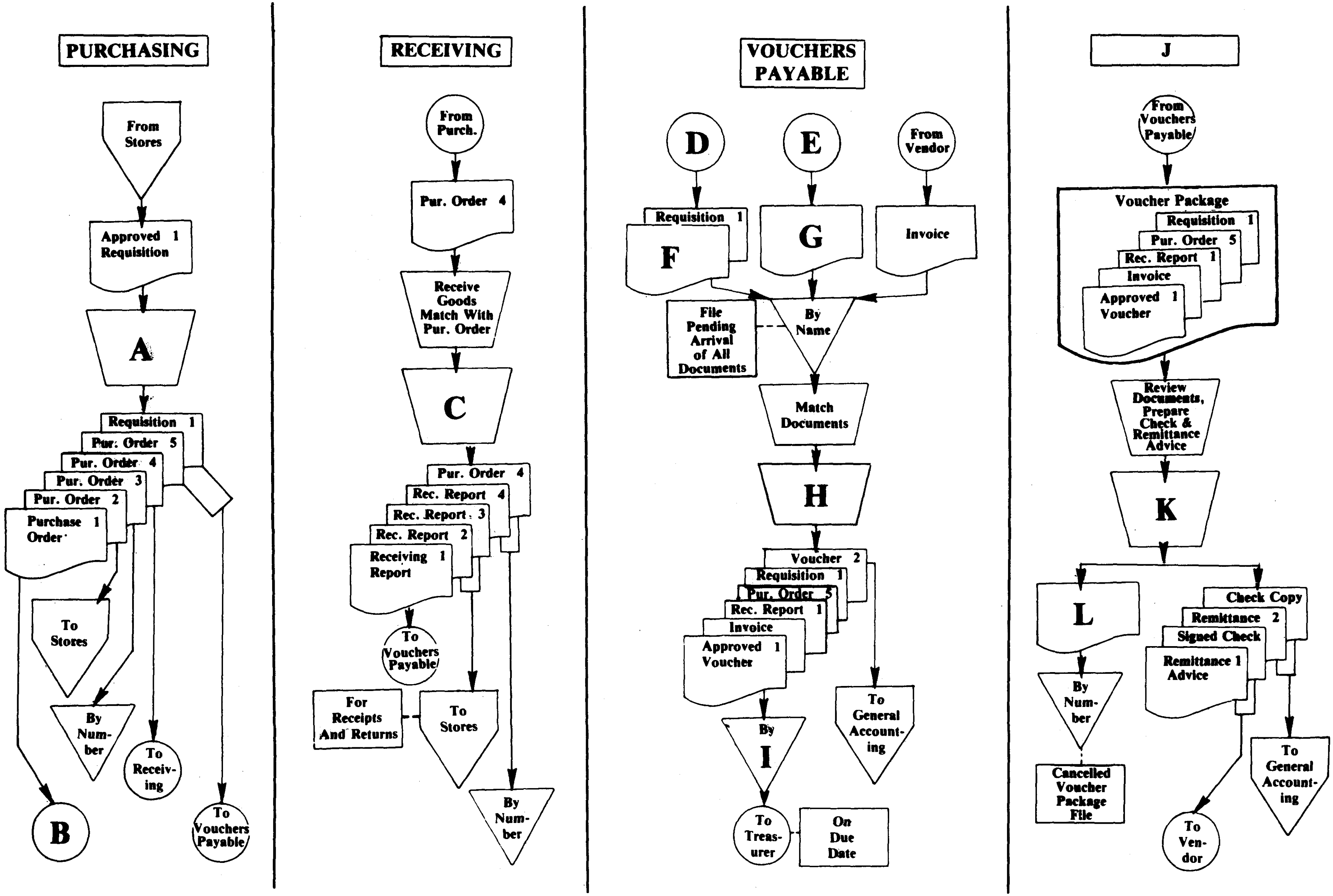
Balance per bank **(a)**		$18,375.91
Deposits in Transit **(b)**		
12/30	1,471.10	
12/31	2,840.69	4,311.79
Subtotal		22,687.70
Outstanding checks **(c)**		
837	6,000.00	
1941	671.80	
1966	320.00	
1984	1,855.42	
1985	3,621.22	
1987	2,576.89	
1991	4,420.88	(19,466.21)
Subtotal		3,221.49
NSF check returned 12/29 **(d)**		200.00
Bank charges		5.50
Error Check No. 1932		148.10
Customer note collected by the bank ($2,750 plus $275 interest) **(e)**		(3,025.00)
Balance per books **(f)**		$ 550.09

Required:

Indicate one or more audit procedures that should be performed by Kautz in gathering evidence in support of each of the items **(a)** through **(f)** above.

Number 5 (Estimated time —— 15 to 25 minutes)

The following illustrates a **MANUAL SYSTEM FOR EXECUTING PURCHASES AND CASH DISBURSEMENTS TRANSACTIONS**



Required:
Indicate what each of the letters (A) through (L) represents. Do not discuss adequacies or inadequacies in the system of internal control.

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN BUSINESS LAW

(Commercial Law)

May 6, 1983; 8:30 A.M. to 12:00 M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	110	130
No. 2	15	20
No. 3	15	20
No. 4	15	20
No. 5	15	20
Total	170	210

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers.

3. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 110 to 130 minutes)

Instructions

Select the **best** answer for each of the following items. Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

99. The text of the letter from Bridge Builders, Inc., to Allied Steel Co. follows:

> We offer to purchase 10,000 tons of No. 4 steel pipe at today's quoted price for delivery two months from today. Your acceptance must be received in five days.

Bridge Builders intended to create a (an)

a. Option contract.
b. Unilateral contract.
c. Bilateral contract.
d. Joint contract.

Answer Sheet

99. ⓐ ⓑ ● ⓓ

Items to be Answered

1. Wallace, an agent for Lux, made a contract with Doolittle which exceeded Wallace's authority. If Lux wishes to hold Doolittle to the contract, Lux must prove that

a. Lux ratified the contract before withdrawal from the contract by Doolittle.
b. Wallace was acting in the capacity of an agent for an undisclosed principal.
c. Wallace believed he was acting within the scope of his authority.
d. Wallace was Lux's general agent even though Wallace exceeded his authority.

2. Terrence has been Pauline's agent in the liquor business for ten years and has made numerous contracts on Pauline's behalf. Under which of the following situations could Terrence continue to have power to bind Pauline?

a. The passage of a federal constitutional amendment making the sale or purchase of alcoholic beverages illegal.
b. The death of Pauline without Terrence's knowledge.
c. The bankruptcy of Pauline with Terrence's knowledge.
d. The firing of Terrence by Pauline.

3. For which of the following purposes is a general partnership recognized as an entity by the Uniform Partnership Act?

a. Recognition of the partnership as the employer of its partners.
b. Insulation of the partners from personal liability.
c. Taking of title and ownership of property.
d. Continuity of existence.

4. Donovan, a partner of Monroe, Lincoln, and Washington, is considering selling or pledging all or part of his interest in the partnership. The partnership agreement is silent on the matter. Donovan can

a. Sell part but not all of his partnership interest.
b. Sell or pledge his entire partnership interest without causing a dissolution.
c. Pledge his partnership interest, but only with the consent of his fellow partners.
d. Sell his entire partnership interest and confer partner status upon the purchaser.

5. In determining the liability of a partnership for the acts of a partner purporting to act for the partnership without the authorization of fellow partners, which of the following actions will bind the partnership?

a. The renewal of an existing supply contract which the other partners had decided to terminate and which they had specifically voted against.
b. An assignment of the partnership assets in trust for the benefit of creditors.
c. A written admission of liability in a lawsuit brought against the partnership.
d. Signing the partnership name as a surety on a note for the purchase of that partner's summer home.

6. In determining whether a bilateral contract has been created, the courts look primarily at

a. The fairness to the parties.
b. The objective intent of the parties.
c. The subjective intent of the parties.
d. The subjective intent of the offeror.

7. Dougal is seeking to avoid performing a promise to pay Clark $500. Dougal is relying upon lack of consideration on Clark's part sufficient to support his promise. Dougal will prevail if he can establish that

a. The contract is executory.
b. Clark's asserted consideration is worth only $100.
c. Prior to Dougal's promise, Clark had already performed the requested act.
d. Clark's only claim of consideration was the relinquishment of a legal right.

8. Justin made an offer to pay Benson $1,000 if Benson would perform a certain act. Acceptance of Justin's offer occurs when Benson
   a. Promises to complete the act.
   b. Prepares to perform the act.
   c. Promises to perform and begins preliminary performance.
   d. Completes the act.

9. Luxor wrote Harmon offering to sell Harmon Luxor's real estate business for $200,000. Harmon sent a telegram accepting the offer at $190,000. Later, learning that several other parties were interested in purchasing the business, Harmon telephoned Luxor and made an unqualified acceptance on Luxor's terms. The telegram arrived an hour after the phone call. Under the circumstances
   a. Harmon's telegram effectively terminated the offer.
   b. Harmon's oral acceptance is voidable, because real estate is involved.
   c. The offer was revoked as a result of Harmon's learning that others were interested in purchasing the business.
   d. Harmon has made a valid contract at $200,000.

10. Fairbanks, an author, was approached by Nickle Corporation to ghostwrite the history of Nickle for $15,000. Larson, the president of Nickle, told Fairbanks the job was his if he would agree to cleverly defame its leading competitor, Mogul Corporation, using sly innuendo and clever distortion of the facts. Fairbanks wrote the history. It turned out that the Mogul passages were neither sly nor clever and Mogul obtained a judgment against Nickle. Fairbanks is seeking to collect the final $5,000 installment on the contract. Nickle refuses to pay and seeks to recover the $10,000 it has already paid. In the event of a lawsuit
   a. Fairbanks will recover $5,000.
   b. The court will deny relief to either party.
   c. Nickle will recover $10,000.
   d. Fairbanks will recover in quantum meruit for the value of his services.

11. Glass Co. telephoned Hourly Company and ordered 2,000 watches at $2 each. Glass agreed to pay 10% immediately and the balance within ten days after receipt of the entire shipment. Glass forwarded a check for $400 and Hourly shipped 1,000 watches the next day, intending to ship the balance by the end of the week. Glass decided that the contract was a bad bargain and repudiated it, asserting the Statute of Frauds. Hourly sued Glass. Which of the following will allow Hourly to enforce the contract in its entirety despite the Statute of Frauds?
   a. Glass admitted in court that it made the contract in question.
   b. Hourly shipped 1,000 watches.
   c. Glass paid 10% down.
   d. The contract is **not** within the requirements of the Statute.

12. The Statute of Frauds
   a. Codified common law rules of fraud.
   b. Requires that formal contracts be in writing and signed by the parties to the contract.
   c. Does **not** apply if the parties waive its application in the contract.
   d. Sometimes results in a contract being enforceable by only one party.

13. Certain oral contracts fall outside the Statute of Frauds. An example would be a contract between
   a. A creditor and a friend of the debtor, providing for the friend's guaranty of the debt in exchange for the creditor's binding extension of time for payment of the debt.
   b. A landlord and a tenant for the lease of land for ten years.
   c. A school board and a teacher entered into on January 1, for nine months of service to begin on September 1.
   d. A retail seller of television sets and a buyer for the sale of a TV set for $399 C.O.D.

14. Silvers entered into a contract which contains a substantial arithmetical error. Silvers asserts mistake as a defense to his performance. Silvers will prevail
   a. Only if the mistake was a mutual mistake.
   b. Only if the error was **not** due to his negligence.
   c. If the error was unilateral and the other party knew of it.
   d. If the contract was written by the other party.

15. Smith, an executive of Apex Corporation, became emotionally involved with Jones. At the urging of Jones, and fearing that Jones would sever their relationship, Smith reluctantly signed a contract which was grossly unfair to Apex. Apex's best basis to rescind the contract would be
   a. Lack of express authority.
   b. Duress.
   c. Undue influence.
   d. Lack of consideration.

16. Elrod is attempting to introduce oral evidence in court to explain or modify a written contract he made with Weaver. Weaver has pleaded the parol evidence rule. In which of the following circumstances will Elrod **not** be able to introduce the oral evidence?
   a. The modification asserted was made several days after the written contract had been executed.
   b. The contract indicates that it was intended as the "entire contract" between the parties, and the point is covered in detail.
   c. There was a mutual mistake of fact by the parties regarding the subject matter of the contract.
   d. The contract contains an obvious ambiguity on the point at issue.

17. Nancy is asserting rights as a third party donee beneficiary on a contract made by Johnson and Harding. In order to prevail, Nancy must prove that
  a. The contract specifically named her as the beneficiary.
  b. She gave consideration for the donative promise.
  c. She is related by blood or marriage to the promisee.
  d. The terms of the contract and surrounding circumstances manifest a clear intent to benefit her.

18. The assignment of a contract right
  a. Will **not** be enforceable if it materially varies the obligor's promise.
  b. Is invalid unless supported by consideration.
  c. Gives the assignee better rights against the obligor than the assignor had.
  d. Does not create any rights in the assignee against the assignor until notice is given to the obligor.

19. Kent Construction Company contracted to construct four garages for Magnum, Inc., according to specifications provided by Magnum. Kent deliberately substituted 2×4s for the more expensive 2×6s called for in the contract in all places where the 2×4s would not be readily detected. Magnum's inspection revealed the variance and Magnum is now withholding the final payment on the contract. The contract was for $100,000, and the final payment would be $25,000. Damages were estimated to be $15,000. In a lawsuit for the balance due, Kent will
  a. Prevail on the contract, less damages of $15,000, because it has substantially performed.
  b. Prevail because the damages in question were not substantial in relation to the contract amount.
  c. Lose because the law unqualifiedly requires literal performance of such contracts.
  d. Lose all rights under the contract because it has intentionally breached it.

20. Myers entered into a contract to purchase a valuable rare coin from Eisen. Myers tendered payment which was refused by Eisen. Upon Eisen's breach, Myers brought suit to obtain the coin. The court will grant Myers
  a. Compensatory damages.
  b. Specific performance.
  c. Reformation.
  d. Restitution.

21. A voluntary bankruptcy proceeding is available to
  a. All debtors provided they are insolvent.
  b. Debtors only if the overwhelming preponderance of creditors have **not** petitioned for and obtained a receivership pursuant to state law.
  c. Corporations only if a reorganization has been attempted and failed.
  d. Most debtors even if they are **not** insolvent.

22. An involuntary petition in bankruptcy
  a. Will be denied if a majority of creditors in amount and in number have agreed to a common law composition agreement.
  b. Can be filed by creditors only once in a seven-year period.
  c. May be successfully opposed by the debtor by proof that the debtor is solvent in the bankruptcy sense.
  d. If **not** contested will result in the entry of an order for relief by the bankruptcy judge.

23. A bankrupt who has voluntarily filed for and received a discharge in bankruptcy
  a. Will receive a discharge of any and all debts owed by him as long as he has **not** committed a bankruptcy offense.
  b. Can obtain another voluntary discharge in bankruptcy after five years have elapsed from the date of the prior discharge.
  c. Must surrender for distribution to the creditors amounts received as an inheritance if the receipt occurs within 180 days after filing of the petition.
  d. Is precluded from owning or operating a similar business for two years.

24. Hard Times, Inc., is insolvent. Its liabilities exceed its assets by $13 million. Hard Times is owned by its president, Waters, and members of his family. Waters, whose assets are estimated at less than a million dollars, guaranteed the loans of the corporation. A consortium of banks is the principal creditor of Hard Times having loaned it $8 million, the bulk of which is unsecured. The banks decided to seek reorganization of Hard Times and Waters has agreed to cooperate. Regarding the proposed reorganization
  a. Waters' cooperation is necessary since he must sign the petition for a reorganization.
  b. If a petition in bankruptcy is filed against Hard Times, Waters will also have his personal bankruptcy status resolved and relief granted.
  c. Only a duly constituted creditors committee may file a plan of reorganization of Hard Times.
  d. Hard Times will remain in possession unless a request is made to the court for the appointment of a trustee.

25. A distinction between a surety and a cosurety is that only one is entitled to
    a. Compensation.
    b. Subrogation.
    c. Contribution.
    d. Notice upon default.

26. A release of a cosurety by the creditor
    a. Will have **no** effect on the obligation of the other cosurety.
    b. Will release the other cosurety entirely.
    c. Will release the other cosurety to the extent that his right to contribution has been adversely affected.
    d. Need **not** be a binding release in order to affect the rights of the parties.

27. The right of subrogation
    a. May permit the surety to assert rights he otherwise could **not** assert.
    b. Is denied in bankruptcy.
    c. Arises only to the extent that it is provided in the surety agreement.
    d. Can **not** be asserted by a cosurety unless he includes all other cosureties.

28. Prior to a bulk transfer, the creditors of the transferor are entitled to
    a. Examine the books and records of the transferee in order to determine credit-worthiness.
    b. Require that the transferee post an adequate surety bond guaranteeing proper performance.
    c. Prevent the proposed bulk transfer from taking place if the creditors will meet the terms offered by the transferee in the transfer agreement.
    d. Notice at least 10 days before the transferee takes possession of the goods or pays for them, whichever occurs first.

29. Johnstone purchased all the inventory, machinery, and fixtures of Lomax. Johnstone failed to comply with the requirements of the Bulk Transfers Article of the Uniform Commercial Code. Dark subsequently purchased some of the used machinery from Johnstone. Dark
    a. Must give notice to Lomax's creditors who sold the machinery to Lomax.
    b. Will take free of the claims of Lomax's creditors irrespective of Dark's good faith or notice since the creditors must seek recourse from Johnstone exclusively.
    c. Will have a voidable title even if he took in good faith and without notice.
    d. Takes subject to any title defect if he had notice of Johnstone's failure to comply.

30. Which of the following transfers by a transferor is subject to the Bulk Transfers Article of the Uniform Commercial Code?
    a. The transfer of property to creditors to provide security for performance of an obligation.
    b. The transfer to a buyer of some equipment used in the business along with the major part of the inventories, materials, and supplies.
    c. A transfer made to a vendor in settlement of a security interest.
    d. A transfer made to a creditor pursuant to settlement of a judicial lien.

31. Grubar is a troublesome appliance price-cutter. The other retail appliance dealers dislike Grubar's price cutting and he is equally unpopular with the appliance manufacturers. Grubar's appliance sales constitute less than .001% of the market. The marketplace has an abundance of retailers, and competition is vigorous. The manufacturers and the retailers jointly decided to boycott Grubar, thereby significantly limiting the availability of appliances to him, and thus hoping to drive him out of business. Grubar has commenced legal action against the various parties based upon a violation of the Sherman Act. He is seeking injunctive relief and damages. Under the circumstances
    a. Grubar is entitled to the relief requested since the facts indicate a per se violation.
    b. Grubar's complaint should be dismissed since it alleges only a private wrong as contrasted with a public wrong.
    c. Grubar is entitled to the relief requested against the interstate commerce manufacturers, but not the intrastate retailers.
    d. Grubar is **not** entitled to injunctive relief since only the Department of Justice is entitled to obtain such relief.

32. Pratt Company manufactures and sells distinctive clocks. Its best selling item is a reproduction of a rare antique grandfather clock. Taylor Co. purchased 100 of the clocks from Pratt at $99 each. Much to Taylor's chagrin it discovered that Stewart, one of its competitors, had purchased the same clock from Pratt at $94 per clock. Taylor has complained and threatened legal action. In the event the issue is litigated
    a. Taylor has a presumption in its favor that it has been harmed by price discrimination.
    b. Pratt will prevail if it can show it did **not** intend to harm Taylor.
    c. Pratt will prevail if it can show that it sold the clocks at the lower price to all customers such as Stewart who had been doing business with it continuously for ten years or more.
    d. Pratt will prevail if it can establish that there were several other clock companies with which Taylor could deal if Taylor were dissatisfied.

33. Section 7 of the Clayton Act is the primary statutory provision used by the Department of Justice in controlling anticompetitive mergers and acquisitions. In general, the Clayton Act is invoked because
   a. It provides for harsher criminal penalties than does the Sherman Act.
   b. It enables the Department of Justice to proscribe mergers and acquisitions in their incipiency.
   c. It provides for exclusive jurisdiction over such activities.
   d. The Sherman Act applies to asset mergers or acquisitions only and **not** to stock mergers or acquisitions.

34. Fairfax was employed by Wexford Manufacturing Company as a salaried salesman. While Fairfax was driving a company car on a sales call, a truck owned and operated by Red Van Lines ran a stop light and collided with Fairfax's car. Fairfax applied for and received worker's compensation for the injuries sustained. As a result of receiving worker's compensation, Fairfax
   a. Must assign any negligence cause of action to Wexford pursuant to the doctrine of respondeat superior.
   b. Is precluded from suing Red for negligence because of the worker's compensation award.
   c. Can recover in full against Red for negligence, but must return any duplication of the worker's compensation award.
   d. Can recover in full against Red for negligence and retain the full amounts awarded under worker's compensation.

35. Which of the following is a part of the social security law?
   a. A self-employed person must contribute an annual amount which is less than the combined contributions of an employee and his or her employer.
   b. Upon the death of an employee prior to his retirement, his estate is entitled to receive the amount attributable to his contributions as a death benefit.
   c. Social security benefits must be fully funded and payments, current and future, must constitutionally come only from social security taxes.
   d. Social security benefits are taxable as income when they exceed the individual's total contributions.

36. The insurable interest in property
   a. Can be waived by consent of the parties.
   b. Is subject to the incontestability clause.
   c. Must be present at the time the loss occurs.
   d. Is only available to owners, occupiers, or users of the property.

37. The underlying rationale which justifies the use of the coinsurance clause in fire insurance is
   a. It provides an insurable interest in the insured if this is **not** already present.
   b. To require certain minimum coverage in order to obtain full recovery on losses.
   c. It prevents arson by the owner.
   d. It makes the insured more careful in preventing fires since the insured is partially at risk in the event of loss.

38. A merchant's irrevocable written offer (firm offer) to sell goods
   a. Must be separately signed if the offeree supplies a form contract containing the offer.
   b. Is valid for three months unless otherwise provided.
   c. Is nonassignable.
   d. Can **not** exceed a three-month duration even if consideration is given.

39. In general, disclaimers of implied warranty protection are
   a. Permitted if they are explicit and understandable and the buyer is aware of their existence.
   b. Not binding on remote purchasers with notice thereof.
   c. Void because they are against public policy.
   d. Invalid unless in writing and signed by the buyer.

40. The Uniform Commercial Code's position on privity of warranty as to personal injuries
   a. Resulted in a single uniform rule being adopted throughout most of the United States.
   b. Prohibits the exclusion on privity grounds of third parties from the warranty protection it has granted.
   c. Applies exclusively to manufacturers.
   d. Allows the buyer's family the right to sue only the party from whom the buyer purchased the product.

41. With respect to written contracts, the parol evidence rule applies
   a. Exclusively to the purchase or sale of goods.
   b. To subsequent oral modifications.
   c. Only to prior or contemporaneous oral modifications.
   d. To modifications by prior written or oral agreements.

42. On February 1, 1983, Nugent Manufacturing, Inc. contracted with Costello Wholesalers to supply Costello with 1,000 integrated circuits. Delivery was called for on May 1, 1983. On March 15, 1983, Nugent notified Costello that it would not perform and that Costello should look elsewhere. Nugent had received a larger and more lucrative contract on February 27, 1983, and its capacity was such that it could not fulfill both orders. The facts
   a. Are **not** sufficient to clearly establish an anticipatory repudiation.
   b. Will prevent Nugent from retracting its repudiation of the Costello contract.
   c. Will permit Costello to sue immediately after March 15, 1983, even though the performance called for under the contract was not until May 1, 1983.
   d. Will permit Costello to sue only after May 1, 1983, the latest performance date.

43. The Uniform Commercial Code deals differently with negotiable documents of title than with commercial paper. Which of the following will prevent a due negotiation of a negotiable document of title?
   a. The transfer by delivery alone of a title document which has been endorsed in blank.
   b. The receipt of the instrument in payment of an antecedent money obligation.
   c. The taking of a bearer document of title from one who lacks title thereto.
   d. The fact that the document of title is more than one month old.

44. Under the Uniform Commercial Code's rule, a warehouseman
   a. Is liable as an insurer.
   b. Will **not** be liable for the nonreceipt or misdescription of the goods stored even to a good faith purchaser for value of a warehouse receipt.
   c. Can **not** limit its liability in respect to loss or damage to goods while in its possession.
   d. Is liable for damages which could have been avoided through the exercise of due care.

45. A negotiable bill of lading
   a. Is one type of commercial paper as defined by the Uniform Commercial Code.
   b. Can give certain good faith purchasers greater rights to the bill of lading or the goods than the transferor had.
   c. Can **not** result in a loss to the owner if lost or stolen, provided prompt notice is given to the carrier in possession of the goods.
   d. Does **not** give the rightful possessor the ownership of the goods.

46. Dwight Corporation purchased the following instrument in good faith from John Q. Billings:

> No. 7200 ••• REGISTERED ••• $10,000
> Magnum Cum Laude Corporation
>
> Ten year 14% Debenture, Due May 15, 1990
>
> Magnum Cum Laude Corporation, a Delaware Corporation, for value received, hereby promises to pay the sum of TEN THOUSAND DOLLARS ($10,000) to JOHN Q. BILLINGS, or registered assigns, at the principal office or agency of the Corporation in Wilmington, Delaware.

On the reverse side of the instrument, the following appeared:

"For value received, the undersigned sells, assigns, and transfers unto DWIGHT CORPORATION, (signed) JOHN Q. BILLINGS." Billings' signature was guaranteed by Capital Trust Company.

Magnum's 14% debentures are listed on the Pacific Coast Exchange. The instrument is
   a. A registered negotiable investment security which Dwight took free of adverse title claims.
   b. Nonnegotiable since the instrument must be registered with Magnum to be validly transferred.
   c. Negotiable commercial paper.
   d. A nonnegotiable investment security since the instrument lacks the words of negotiability, "to the order of or bearer."

47. Attachment and perfection will occur simultaneously when
   a. The security agreement so provides.
   b. There is a purchase money security interest taken in inventory.
   c. Attachment is by possession.
   d. The goods are sold on consignment.

48. Perfection of a security interest by a creditor provides added protection against other parties in the event the debtor does not pay his debts. Which of the following is **not** affected by perfection of a security interest?
   a. A buyer in the ordinary course of business.
   b. A subsequent personal injury judgment creditor.
   c. The trustee in a bankruptcy proceeding.
   d. Other prospective creditors of the debtor.

49. On November 10, 1982, Cutter, a dealer, purchased 100 lawnmowers. This comprised Cutter's entire inventory and was financed under an agreement with Town Bank which gave the bank a security interest in all lawnmowers on the premises, all future acquired lawnmowers, and the proceeds of sales. On November 15, 1982, Town Bank filed a financing statement that adequately identified the collateral. On December 20, 1982, Cutter sold one lawnmower to Wills for family use and five lawnmowers to Black for its gardening business. Which of the following is correct?.

a. The security interest may not cover after-acquired property even if the parties so agree.
b. The lawnmower sold to Wills would **not** ordinarily continue to be subject to the security interest.
c. The lawnmowers sold to Black would ordinarily continue to be subject to the security interest.
d. The security interest does **not** include the proceeds from the sale of the lawnmowers to Black.

50. Attachment under Article 9 of the Uniform Commercial Code applies primarily to the rights of

a. Third party creditors.
b. Parties to secured transactions.
c. Holders in due course.
d. Warehousemen.

51. Fogel purchased a TV set for $900 from Hamilton Appliance Store. Hamilton took a promissory note signed by Fogel and a security interest for the $800 balance due on the set. It was Hamilton's policy not to file a financing statement until the purchaser defaulted. Fogel obtained a loan of $500 from Reliable Finance which took and recorded a security interest in the set. A month later, Fogel defaulted on several loans outstanding and one of his creditors, Harp, obtained a judgment against Fogel which was properly recorded. After making several payments, Fogel defaulted on a payment due to Hamilton, who then recorded a financing statement subsequent to Reliable's filing and the entry of the Harp judgment. Subsequently, at a garage sale, Fogel sold the set for $300 to Mobray. Which of the parties has the priority claim to the set?

a. Reliable.
b. Hamilton.
c. Harp.
d. Mobray.

52. Gilbert borrowed $10,000 from Merchant National Bank and signed a negotiable promissory note which contained an acceleration clause. In addition, securities valued at $11,000 at the time of the loan were pledged as collateral. Gilbert has defaulted on the loan repayments. At the time of default, $9,250, plus interest of $450, was due, and the securities had a value of $8,000. Merchant

a. Must first proceed against the collateral before proceeding against Gilbert personally on the note.
b. Can **not** invoke the acceleration clause in the note until ten days after the notice of default is given to Gilbert.
c. Must give Gilbert 30 days after default in which to refinance the loan.
d. Is entitled to proceed against Gilbert on either the note or the collateral or both.

53. Wilmont owned a tract of waterfront property on Big Lake. During Wilmont's ownership of the land, several frame bungalows were placed on the land by tenants who rented the land from Wilmont. In addition to paying rent, the tenants paid for the maintenance and insurance of the bungalows, repaired, altered and sold them, without permission or hindrance from Wilmont. The bungalows rested on surface cinderblock and were not bolted to the ground. The buildings could be removed without injury to either the buildings or the land. Wilmont sold the land to Marsh. The deed to Marsh recited that Wilmont sold the land, with buildings thereon, "subject to the rights of tenants, if any, ..." When the tenants attempted to remove the bungalows, Marsh claimed ownership of them. In deciding who owns the bungalows, which of the following is **least** significant?

a. The leasehold agreement itself, to the extent it manifested the intent of the parties.
b. The mode and degree of annexation of the buildings to the land.
c. The degree to which removal would cause injury to the buildings or the land.
d. The fact that the deed included a general clause relating to the buildings.

54. Fosdick's land adjoins Tracy's land and Tracy has been using a trail across Fosdick's land for a number of years. The trail is the shortest route to a roadway which leads into town. Tracy is asserting a right to continue to use the trail despite Fosdick's objections. In order to establish an easement by prescription, Tracy must show

a. Implied consent by Fosdick.
b. Use of the trail for the applicable statutory period.
c. His use of the trail with an intent to assert ownership to the underlying land.
d. Prompt recordation of the easement upon its coming into existence.

55. Smith purchased a tract of land. To protect himself, he ordered title insurance from Valor Title Insurance Company. The policy was the usual one issued by title companies. Accordingly

a. Valor will **not** be permitted to take exceptions to its coverage if it agreed to insure and prepared the title abstract.
b. The title policy is assignable in the event Smith subsequently sells the property.
c. The title policy provides protection against defects in record title only.
d. Valor will be liable for any title defect which arises, even though the defect could **not** have been discovered through the exercise of reasonable care.

56. Purdy purchased real property from Hart and received a warranty deed with full covenants. Recordation of this deed is

a. Not necessary if the deed provides that recordation is **not** required.
b. Necessary to vest the purchaser's legal title to the property conveyed.
c. Required primarily for the purpose of providing the local taxing authorities with the information necessary to assess taxes.
d. Irrelevant if the subsequent party claiming superior title had actual notice of the unrecorded deed.

57. Which of the following is an **incorrect** statement regarding a real property mortgage?

a. It transfers title to the real property to the mortgagee.
b. It is invariably accompanied by a negotiable promissory note which refers to the mortgage.
c. It creates an interest in real property and is therefore subject to the Statute of Frauds.
d. It creates a nonpossessory security interest in the mortgagee.

58. Recordation of a real property mortgage

a. Is required to validate the rights of the parties to the mortgage.
b. Will **not** be effective if improperly filed even if the party claiming superior title had actual notice of its existence.
c. Perfects the interest of the mortgagee against subsequent bona fide purchasers for value.
d. Must be filed in the recordation office where the mortgagee's principal place of business is located.

59. Moch sold her farm to Watkins and took back a purchase money mortgage on the farm. Moch failed to record the mortgage. Moch's mortgage will be valid against all of the following parties **except**

a. The heirs or estate of Watkins.
b. A subsequent mortgagee who took a second mortgage since he had heard there was a prior mortgage.
c. A subsequent bona fide purchaser from Watkins.
d. A friend of Watkins to whom the farm was given as a gift and who took without knowledge of the mortgage.

60. Peters defaulted on a purchase money mortgage held by Fairmont Realty. Fairmont's attempts to obtain payment have been futile and the mortgage payments are several months in arrears. Consequently, Fairmont decided to resort to its rights against the property. Fairmont foreclosed on the mortgage. Peters has all of the following rights **except**

a. To remain in possession as long as his equity in the property exceeds the amount of debt.
b. An equity of redemption.
c. To refinance the mortgage with another lender and repay the original mortgage.
d. A statutory right of redemption.

Number 2 (Estimated time —— 15 to 20 minutes)

Part a. The common stock of Wilson, Inc. is owned by 20 stockholders who live in several states. Wilson's financial statements as of December 31, 1982, were audited by Doe & Co., CPAs, who rendered an unqualified opinion on the financial statements.

In reliance on Wilson's financial statements, which showed net income for 1982 of $1,500,000, Peters on April 10, 1983, purchased 10,000 shares of Wilson stock for $200,000. The purchase was from a shareholder who lived in another state. Wilson's financial statements contained material misstatements. Because Doe did not carefully follow GAAS it did not discover that the statements failed to reflect unrecorded expenses which reduced Wilson's actual net income to $800,000. After disclosure of the corrected financial statements, Peters sold his shares for $100,000, which was the highest price he could obtain.

Peters has brought an action against Doe under federal securities law and state common law.

Required: Answer the following, setting forth reasons for any conclusions stated.

1. Will Peters prevail on his federal securities law claims?
2. Will Peters prevail on his state common law claims?

Part b. Able Corporation decided to make a public offering of bonds to raise needed capital. On June 30, 1982, it publicly sold $2,500,000 of 12% debentures in accordance with the registration requirements of the Securities Act of 1933.

The financial statements filed with the registration statement contained the unqualified opinion of Baker & Co., CPAs. The statements overstated Able's net income and net worth. Through negligence Baker did not detect the overstatements. As a result, the bonds, which originally sold for $1,000 per bond, have dropped in value to $700.

Ira is an investor who purchased $10,000 of the bonds. He promptly brought an action against Baker under the Securities Act of 1933.

Required: Answer the following, setting forth reasons for any conclusions stated.

Will Ira prevail on his claim under the Securities Act of 1933?

Number 3 (Estimated time —— 15 to 20 minutes)

Part a. Higgins Corporation sells coffee to chain stores and independent grocers. It offers two types of discounts. For the chain stores, Higgins offers a substantial flat discount regardless of volume purchased. For the independent grocers, Higgins grants only volume discounts, on a sliding-scale basis. Higgins received a cease and desist order from the Federal Trade Commission (FTC), and has retained Daniel Chapman, CPA, to assist Higgins in its defense. Basically, the FTC contends that Higgins' discount practices are in violation of the Robinson-Patman Act and thus must be enjoined. Higgins' management has decided not to plead possible defenses of "changed conditions" or "meeting competition" but rather focus exclusively on the "cost justification" defense. Chapman is concerned about the nature and effect of cost data he should obtain.

Required: Answer the following, setting forth reasons for any conclusions stated.

1. Discuss the key issues and problems faced in a cost justification defense.
2. Suppose instead that Higgins had sold coffee under its own brand name to independent grocers, and under a private label to chain stores at a lower price. What ramifications, if any, would this have under a Robinson-Patman action?

Part b. Smith Corp. proposed to merge with Jones, Inc. The stock of both corporations was listed on a national securities exchange. In connection with the merger, both corporations distributed to their shareholders proxy statements seeking their favorable votes.

The shareholders of both corporations overwhelmingly voted in favor of the merger. Following the vote, but before consummation of the merger, the stock of Jones dropped substantially in value, from $10 per share to $5 per share.

The reason for the fall in value was the discovery that Smith Corp. had entered into several highly unprofitable long-term contracts. The contracts, which were not disclosed in the proxy statement, will result in substantial losses from Smith's operations in the coming years. The proxy statements indicate that Smith expected continued profitability for the years in question.

West, a longtime Jones shareholder, opposes the merger and decided to bring legal action under the Securities Exchange Act of 1934.

Required: Answer the following, setting forth reasons for any conclusions stated.

Will West prevail, and if so, what remedy or remedies will be available to him?

Number 4 (Estimated time —— 15 to 20 minutes)

Cox is a disgruntled shareholder of Hall, Inc. She has owned 6% of the voting stock for several years. Hall is a corporation with 425 shareholders. However, the members of the Hall family own 65% of the corporate stock, dominate the board, and are the principal officers of the corporation. There is one minority board member. Recently, there have been major changes in Hall's board and its officers as the older generation of the family has relinquished the management in favor of the next generation of Halls. It is the action of this new board and management that has caused Cox to contemplate taking drastic action against the current board and officers. Specifically, she objects to the following:

- The board has drastically cut the dividend payments on the common stock. The board's explanation is that additional funds for expansion or acquisitions are critical for the growth of the corporation. The earnings have been increasing at a rate of 10% per year during this period. Cox claims that the real reason for the dividend cut is to force minority shareholders such as herself to sell. This claim is based on conjecture on her part. Cox is considering an action against the board to compel reinstatement of the prior dividend payout.

- The board also decided to sell 5,000 shares of treasury stock at $10 a share to raise additional capital. The stock in question had originally been sold at $16 a share and had a $12 par value. It was reacquired at $13 per share. Cox first alleges that the corporation is prohibited from acquiring its own shares without specific authorization in the articles of incorporation. The articles of incorporation are silent on this matter. Cox also asserts that the corporation is prohibited from selling the shares at a price less than par.

- Substantial salaries are paid to the officers of the corporation. Salaries of the newcomers have been increased at an annual rate of 10%, which is far in excess of raises voted by the old board. Cox has evidence to show that the corporation's salary scale has risen from the top 50% to the top 33⅓% of salaries paid by similar corporations in the industry. Cox asserts that based upon the recipients' ages, experience and contribution to the corporation, they are so grossly overpaid that the payments constitute a waste of corporate assets. Cox demands that the salary increases be repaid.

- The board has become factionalized because of hostility within the Hall family. Cox claims that this acrimony has generated useless debate and bickering and is counterproductive to the continued success of Hall, Inc. The majority has threatened to oust the opposition at the next election of the board. Cox claims that all of these actions are seriously impairing the effective management of the corporation and she is contemplating seeking a court-ordered dissolution of Hall.

Required: Answer the following, setting forth reasons for any conclusions stated.

Discuss the merits of each of the above claims and indicate the probable outcome of any court action taken by Cox personally or taken by her forandon behalf of the corporation.

Number 5 (Estimated time —— 15 to 20 minutes)

Part a. Dunhill fraudulently obtained a negotiable promissory note from Beeler by misrepresentation of a material fact. Dunhill subsequently negotiated the note to Gordon, a holder in due course. Pine, a business associate of Dunhill, was aware of the fraud perpetrated by Dunhill. Pine purchased the note for value from Gordon. Upon presentment, Beeler has defaulted on the note.

Required: Answer the following, setting forth reasons for any conclusions stated.

1. What are the rights of Pine against Beeler?
2. What are the rights of Pine against Dunhill?

Part b. Dennison Corporation, a Los Angeles-based manufacturer, recently ordered some hardware from Elba Corporation, a Boston-based seller of fine tools. Unfortunately, all of the hardware was destroyed while in transit by the carrier. Further examination revealed that while one set of tools was shipped under terms F.O.B. Los Angeles, the other set was shipped under terms F.O.B. Boston.

Required: Answer the following, setting forth reasons for any conclusions stated.

1. Which party will bear the risk of loss for each set of tools destroyed in transit assuming conforming goods were shipped?
2. Assume that Dennison also purchased some tools from San Francisco-based Drew Corporation which were shipped under terms F.O.B. San Francisco. The property is found defective upon arrival in Los Angeles. Which party will bear the risk of loss if the property is destroyed immediately after receipt?

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN ACCOUNTING THEORY

(Theory of Accounts)

May 6, 1983; 1:30 to 5:00 P.M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	90	110
No. 2	15	25
No. 3	15	25
No. 4	15	25
No. 5	15	25
Total	150	210

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers.

3. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 90 to 110 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of issues in accounting.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

99. The financial statement which summarizes the financial position of a company is the
    a. Income statement.
    b. Balance sheet.
    c. Statement of changes in financial position.
    d. Retained earnings statement.

Answer Sheet

99. ⓐ ● ⓒ ⓓ

Items to be Answered

1. Under Statement of Financial Accounting Concepts No.2, feedback value is an ingredient of the primary quality of

	Relevance	*Reliability*
a.	No	No
b.	No	Yes
c.	Yes	Yes
d.	Yes	No

2. Under Statement of Financial Accounting Concepts No. 2, which of the following interacts with both relevance and reliability to contribute to the usefulness of information?
    a. Comparability.
    b. Timeliness.
    c. Neutrality.
    d. Predictive value.

3. Under Statement of Financial Accounting Concepts No. 3, interrelated elements that are directly related to measuring performance and status of an enterprise include

	Distribution to owners	*Notes to financial statements*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

4. Under Statement of Financial Accounting Concepts No. 3, gains on assets unsold are identified, in a precise sense, by the term
    a. Unrecorded.
    b. Unrealized.
    c. Unrecognized.
    d. Unallocated.

5. Which of the following is expensed under the principle of systematic and rational allocation?
    a. Salesmen's monthly salaries.
    b. Insurance premiums.
    c. Transportation to customers.
    d. Electricity to light office building.

6. When computing information on a historical cost/constant dollar basis, which of the following is classified as nonmonetary?
    a. Allowance for doubtful accounts.
    b. Accumulated depreciation of equipment.
    c. Unamortized premium on bonds payable.
    d. Advances to unconsolidated subsidiaries.

7. A method of accounting based on measures of current cost or lower recoverable amount, without restatement into units having the same general purchasing power, is
    a. Historical cost/constant dollar accounting.
    b. Historical cost/nominal dollar accounting.
    c. Current cost/constant dollar accounting.
    d. Current cost/nominal dollar accounting.

8. Accumulated changes in the valuation allowance for a long-term marketable equity securities portfolio should be a component of
    a. Current assets.
    b. Noncurrent assets.
    c. Noncurrent liabilities.
    d. Net income.

9. An investor purchased a bond as a long-term investment on January 1. Annual interest was received on December 31. The investor's interest income for the year would be lowest if the bond was purchased at
    a. A discount.
    b. A premium.
    c. Par.
    d. Face value.

10. Lyle, Inc., purchased certain plant assets under a deferred payment contract on December 31, 1982. The agreement was to pay $20,000 at the time of purchase and $20,000 at the end of each of the next five years. The plant assets should be valued at
    a. The present value of a $20,000 ordinary annuity for five years.
    b. $120,000.
    c. $120,000 less imputed interest.
    d. $120,000 plus imputed interest.

11. On July 1 of this year a company received a one-year note receivable bearing interest at the market rate. The face amount of the note receivable and the entire amount of the interest are due on June 30 of next year. At December 31 of this year, the company should report in its balance sheet
    a. A deferred credit for interest applicable to next year.
    b. No interest receivable.
    c. Interest receivable for the entire amount of the interest due on June 30 of next year.
    d. Interest receivable for the interest accruing this year.

12. A method of estimating bad debts that focuses on the income statement rather than the balance sheet is the allowance method based on
    a. Direct write off.
    b. Aging the trade receivable accounts.
    c. Credit sales.
    d. The balance in the trade receivable accounts.

13. When an investor uses the equity method to account for investments in common stock, the investment account will be increased when the investor recognizes
    a. A proportionate interest in the net income of the investee.
    b. A cash dividend received from the investee.
    c. Periodic amortization of the goodwill related to the purchase.
    d. Depreciation related to the excess of market value over book value of the investee's depreciable assets at the date of purchase by the investor.

14. When one machine is retired, the accumulated depreciation account is debited for the original cost of that machine less any residual recovery under which of the following depreciation methods?

	Composite	*Group*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

15. At the end of the expected useful life of a depreciable asset with an estimated 15% salvage value, the accumulated depreciation would equal the original cost of the asset under which of the following depreciation methods?

	Straight-line	*Sum-of-the-years-digits*
a.	Yes	Yes
b.	No	No
c.	Yes	No
d.	No	Yes

16. For a capital lease, an amount equal to the present value at the beginning of the lease term of minimum lease payments during the lease term, excluding that portion of the payments representing executory costs such as insurance, maintenance, and property taxes to be paid by the lessor, together with any profit thereon, should be recorded by the lessee as a (an)
    a. Expense.
    b. Liability but **not** an asset.
    c. Asset but **not** a liability.
    d. Asset and a liability.

17. Should the following fees associated with the registration of an internally developed patent be capitalized?

	Legal fees	*Registration fees*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

18. Which of the following assets acquired in 1983 are amortizable?

	Goodwill	*Trademarks*
a.	No	No
b.	No	Yes
c.	Yes	Yes
d.	Yes	No

19. The premium on a three-year insurance policy expiring on December 31, 1982 was paid in total on January 1, 1980. Assuming that the original payment was recorded as a prepaid asset, how would each of the following be affected in 1982?

	Prepaid assets	*Expenses*
a.	No change	Increase
b.	No change	No change
c.	Decrease	No change
d.	Decrease	Increase

20. A machine with a ten-year useful life is being depreciated on a straight-line basis for financial statement purposes, and over five years for income tax purposes under the accelerated cost recovery system. Assuming that the company is profitable and that there are and have been **no** other timing differences, the related deferred income taxes would be reported in the balance sheet at the end of the first year of the estimated useful life as a
    a. Current liability.
    b. Current asset.
    c. Noncurrent liability.
    d. Noncurrent asset.

21. When a company receives a deposit from a customer to protect itself against nonpayment for future services, the deposit should be classified by the company as
    a. Revenue.
    b. A liability.
    c. Part of the allowance for doubtful accounts.
    d. A deferred credit deducted from accounts receivable.

22. For a six-year capital lease, the portion of the minimum lease payment in the third year applicable to the reduction of the obligation should be
    a. Less than in the second year.
    b. More than in the second year.
    c. The same as in the fourth year.
    d. More than in the fourth year.

23. Should the following bond issue costs be expensed as incurred?

	Legal fees	*Underwriting costs*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

24. For the issuer of a ten-year term bond, the amount of amortization using the interest method would increase each year if the bond was sold at a

	Discount	*Premium*
a.	No	No
b.	Yes	Yes
c.	No	Yes
d.	Yes	No

25. A portion of the proceeds should be allocated to paid-in capital for bonds issued with

	Detachable stock purchase warrants	*Nondetachable stock purchase warrants*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

26. When should an indicated loss on a long-term contract be recognized under the completed-contract method and the percentage-of-completion method, respectively?

	Completed-Contract	*Percentage-of-Completion*
a.	Immediately	Over life of project
b.	Immediately	Immediately
c.	Contract complete	Over life of project
d.	Contract complete	Immediately

27. When treasury stock accounted for by the cost method is subsequently sold for more than its purchase price, the excess of the cash proceeds over the carrying value of the treasury stock should be recognized as
    a. Extraordinary gain.
    b. Income from continuing operations.
    c. Increase in additional paid-in capital:
    d. Increase in retained earnings.

28. In a lease that is recorded as a sales-type lease by the lessor, unearned interest
    a. Does **not** arise.
    b. Should be recognized in full as income at the lease's inception.
    c. Should be amortized over the period of the lease using the straight-line method.
    d. Should be amortized over the period of the lease using the interest method.

29. Rent received in advance by the lessor for an operating lease should be recognized as revenue
    a. When received.
    b. At the lease's inception.
    c. In the period specified by the lease.
    d. At the lease's expiration.

30. When the issuer of bonds exercises the call provision to retire the bonds, the excess of the cash paid over the carrying amount of the bonds should be recognized separately as a (an)
    a. Extraordinary loss.
    b. Extraordinary gain.
    c. Loss from continuing operations.
    d. Loss from discontinued operations.

31. The sum-of-the-years-digits method of depreciation is being used for a machine with a five-year estimated useful life. What would be the fraction applied to the cost to be depreciated in the second year?
    a. 2/3.
    b. 2/15.
    c. 4/15.
    d. 4/5.

32. Compensation cost should be recognized in the income statement of each period in which services are rendered for a compensatory stock option plan for which the date of grant and the measurement date are

	Different	*Identical*
a.	No	No
b.	No	Yes
c.	Yes	Yes
d	Yes	No

33. The maximum annual provision for pension cost permitted is normal cost, plus
   a. 10 percent of past service cost (until fully amortized).
   b. 10 percent of past service cost (until fully amortized), plus 10 percent of any increases or decreases in prior service cost arising on amendments of the plan, plus interest equivalents on the difference between provisions and amounts funded.
   c. Interest equivalents on any unfunded prior service cost, plus a provision for the excess of the actuarially computed value of vested benefits over the total of the pension fund if such excess is **not** at least 5 percent less than the comparable excess at the beginning of the year.
   d. A provision for vested benefits.

34. When equipment held under an operating lease is subleased by the original lessee, the original lessee would account for the sublease as a (an)
   a. Operating lease.
   b. Sales-type lease.
   c. Direct financing lease.
   d. Capital lease.

35. Assuming **no** prior period adjustments, would the following affect net income?

	Interperiod income tax allocation	*Intraperiod income tax allocation*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

36. When a cumulative effect type change in accounting principle is made during the year, the cumulative effect on retained earnings is determined
   a. During the year using the weighted-average method.
   b. As of the date of the change.
   c. As of the beginning of the year in which the change is made.
   d. As of the end of the year in which the change is made.

37. Antidilutive common stock equivalents would generally be used in the calculation of

	Primary earnings per share	*Fully diluted earnings per share*
a.	Yes	Yes
b.	No	Yes
c.	No	No
d.	Yes	No

38. A gain on the sale of a long-term investment should be presented in a statement of changes in financial position of a company with substantial operating profits as a (an)
   a. Deduction from income from continuing operations.
   b. Addition to income from continuing operations.
   c. Source and use of funds.
   d. Use of funds.

39. The retirement of long-term debt by the issuance of common stock should be presented in a statement of changes in financial position as a

	Source of funds	*Use of funds*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

40. Pro forma effects of retroactive application would usually be reported on the face of the income statement for a
   a. Correction of error.
   b. Change in entity.
   c. Change in accounting estimate.
   d. Change in accounting principle.

41. In a business combination how should plant and equipment of the acquired corporation generally be reported under each of the following methods?

	Pooling of interests	*Purchase*
a.	Fair value	Recorded value
b.	Fair value	Fair value
c.	Recorded value	Recorded value
d.	Recorded value	Fair value

42. In accounting for the cost of pension plans, an acceptable actuarial cost method for financial reporting purposes is
   a. Pay-as-you-go.
   b. Unit credit.
   c. Turnover.
   d. Terminal funding.

43. In accounting for a long-term construction contract for which there is a projected profit, the balance in the appropriate asset accounts at the end of the first year of work using the completed-contract method would be
   a. Zero.
   b. The same as the percentage-of-completion method.
   c. Higher than the percentage-of-completion method.
   d. Lower than the percentage-of-completion method.

44. In financial reporting for segments of a business enterprise, the operating profit or loss of a segment should include

	Reasonably allocated common operating costs	*Traceable operating costs*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

45. Inventories would be included in the calculation of which of the following?

	Acid test (quick) ratio	*Working capital (current) ratio*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

46. Supervisory salaries for a manufacturing plant would be an example of which of the following?

	Prime cost	*Conversion cost*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

47. Operating income using direct costing as compared to absorption costing would be higher
   a. When the quantity of beginning inventory equals the quantity of ending inventory.
   b. When the quantity of beginning inventory is more than the quantity of ending inventory.
   c. When the quantity of beginning inventory is less than the quantity of ending inventory.
   d. Under **no** circumstances.

48. Under the two-variance method for analyzing factory overhead, the controllable (budget) variance is the difference between the
   a. Budget allowance based on standard hours allowed and the factory overhead applied to production.
   b. Budget allowance based on standard hours allowed and the budget allowance based on actual hours worked.
   c. Actual factory overhead and the factory overhead applied to production.
   d. Actual factory overhead and the budget allowance based on standard hours allowed.

49. A flexible budget is
   a. Not appropriate when costs and expenses are affected by fluctuations in volume limits.
   b. Appropriate for any relevant level of activity.
   c. Appropriate for control of factory overhead but **not** for control of direct materials and direct labor.
   d. Appropriate for control of direct materials and direct labor but **not** for control of factory overhead.

50. The economic order quantity formula can be used to determine the optimum size of a

	Production run	*Purchase order*
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

51. Which of the following will increase the fund balance of a governmental unit at the end of the fiscal year?
   a. Appropriations are less than expenditures and reserve for encumbrances.
   b. Appropriations are less than expenditures and encumbrances.
   c. Appropriations are more than expenditures and encumbrances.
   d. Appropriations are more than estimated revenues.

52. Which of the following accounts of a governmental unit is credited to close it out at the end of the fiscal year?
   a. Appropriations.
   b. Revenues.
   c. Reserve for encumbrances.
   d. Encumbrances.

53. Which of the following accounts of a governmental unit is credited when taxpayers are billed for property taxes?
   a. Estimated revenues.
   b. Revenues.
   c. Appropriations.
   d. Reserve for encumbrances.

54. Which of the following funds of a governmental unit uses the modified accrual basis of accounting?
   a. General.
   b. Enterprise.
   c. Internal service.
   d. Nonexpendable trust.

55. Which of the following funds of a governmental unit would account for depreciation in the accounts of the fund?
   a. General.
   b. Internal service.
   c. Capital projects.
   d. Special assessment.

56. Which of the following funds of a governmental unit uses the same basis of accounting as the special revenue fund?
   a. Internal service.
   b. Expendable trust.
   c. Nonexpendable trust.
   d. Enterprise.

57. Which of the following funds of a governmental unit would account for long-term liabilities in the accounts of the fund?
   a. Special assessment.
   b. Special revenue.
   c. Capital projects.
   d. Debt service.

58. Which of the following accounts would be included in the asset section of the combined balance sheet of a governmental unit for the general long-term debt account group?

	Amount available in debt service funds	*Amount to be provided for retirement of general long-term debt*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

59. Revenues of a municipality should be recognized in the accounting period in which they become available and measurable for a

	Governmental fund	*Proprietary fund*
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

60. Tuition waivers for which there is **no** intention of collection from the student should be classified by a not-for-profit university as

	Revenue	*Expenditures*
a.	No	No
b.	No	Yes
c.	Yes	Yes
d.	Yes	No

Number 2 (Estimated time —— 15 to 25 minutes)

Taylor Company, a household appliances dealer, purchases its inventories from various suppliers. Taylor has consistently stated its inventories at the lower of cost (FIFO) or market.

Required:

a. Taylor is considering alternate methods of accounting for the cash discounts it takes when paying its suppliers promptly. From a theoretical standpoint, discuss the acceptability of each of the following methods:

1. Financial income when payments are made.
2. Reduction of cost of goods sold for period when payments are made.
3. Direct reduction of purchase cost.

b. Identify the effects on both the balance sheet and the income statement of using the LIFO inventory method instead of the FIFO method over a substantial time period when purchase prices of household appliances are rising. State why these effects take place.

c. Why is the lower of cost-or-market rule used for valuing inventories when the FIFO method is used?

Number 3 (Estimated time —— 15 to 25 minutes)

Lynch Company's Statement of Stockholders' Equity and Statement of Retained Earnings at December 31, 1982, and December 31, 1981 are presented below:

Lynch Company
STATEMENT OF STOCKHOLDERS' EQUITY

	December 31,	
	1982	1981
	(000 omitted)	
Common stock, par value $1.00 per share; authorized 40,000,000 shares; issued 22,000,000 shares at December 31, 1982 and 20,000,000 shares at December 31, 1981	$ 22,000	$ 20,000
Additional paid-in capital	240,000	222,000
Retained earnings	296,000	280,000
	$558,000	$522,000

Lynch Company
STATEMENT OF RETAINED EARNINGS

	Year ended December 31,	
	1982	1981
	(000 omitted)	
Retained earnings at beginning of period, as previously reported	$280,000	$264,000
Adjustment for extraordinary item	14,000	—
Retained earnings at beginning of period, as restated	294,000	264,000
Net income	52,400	47,400
Adjustment for correction of error	—	(11,000)
Cash dividends	(24,400)	(20,400)
10% stock dividend	(20,000)	—
Treasury stock	(6,000)	—
Retained earnings at end of period	$296,000	$280,000

Additional facts are as follows:

- The extraordinary item of $14,000,000 is net of income taxes of $8,000,000.
- On January 15, 1982, Lynch Company declared a 10% stock dividend from previously unissued stock. The closing market price of Lynch Company common stock on the New York Stock Exchange was $10 per share on January 15, 1982.
- On July 16, 1982, Lynch Company purchased 500,000 shares of its own common stock for $12 per share. The cost method of accounting was used for this treasury stock transaction.

Required:

a. Determine whether the presentation of the following in the Lynch Company Statement of Retained Earnings is appropriate:

- Adjustment for extraordinary item.
- Adjustment for correction of error.
- 10% stock dividend.
- Treasury stock.

If the presentation is appropriate, explain why. If the presentation is not appropriate, specify the appropriate presentation and explain why.

Do not discuss disclosure requirements for the Notes to the Financial Statements.

b. How did the additional facts above concerning the stock dividend and treasury stock transaction affect the cash dividend per-share (pay-out) ratio?

Number 4 (Estimated time —— 15 to 25 minutes)

Part a. Noble Manufacturing Company uses the weighted-average method of process costing when computing manufacturing cost per equivalent unit. The work in process inventory at the beginning of the period was complete as to materials, and one-third complete as to conversion costs. The work in process inventory at the end of the period was complete as to materials, and one-quarter complete as to conversion costs.

Required:

1. Describe how the cost of the beginning work in process inventory is handled using the weighted-average method of process costing when computing manufacturing cost per equivalent unit. Do not describe determination of equivalent units.
2. Identify the conditions under which the weighted-average method of process costing would be inappropriate.
3. Specify the advantages of the weighted-average method of process costing in contrast to the first-in, first-out method.
4. How would Noble compute the amount of the conversion cost portion of its ending work in process inventory using the weighted-average method?

Part b. Daly Company has determined the number of units of Product Y that Daly would have to sell in order to break even. However, Daly would like to attain a 20 percent profit on sales of Product Y.

Required:

1. Explain how breakeven analysis can be used to determine the number of units of Product Y that Daly would have to sell to attain a 20 percent profit on sales.
2. If variable cost per unit increases as a percentage of the sales price, how would that affect the number of units of Product Y that Daly would have to sell in order to break even and why?
3. Identify the limitations of breakeven analysis in managerial decision making.

Number 5 (Estimated time —— 15 to 25 minutes)

Part a. Reece Company sells two types of merchandise, Type A and Type B. Each carries a one-year warranty.

- Type A merchandise — Product warranty costs, based on past experience, will normally be 1% of sales.
- Type B merchandise — Product warranty costs cannot be reasonably estimated because this is a new product line. However, the chief engineer believes that product warranty costs are likely to be incurred.

Required:

How should Reece report the estimated product warranty costs for each of the two types of merchandise above? Discuss the rationale for your answer. Do not discuss deferred income tax implications, or disclosures that should be made in Reece's financial statements or notes.

Part b. Carpenter Company is being sued for $2,000,000 for an injury caused to a child as a result of alleged negligence while the child was visiting the Carpenter Company plant in March 1982. The suit was filed in July 1982. Carpenter's lawyer states that it is probable that Carpenter will lose the suit and be found liable for a judgment costing anywhere from $200,000 to $900,000. However, the lawyer states that the most probable judgment is $400,000.

Required:

How should Carpenter report the suit in its 1982 financial statements? Discuss the rationale for your answer. Include in your answer disclosures, if any, that should be made in Carpenter's financial statements or notes.

Uniform Certified Public Accountant Examination

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN ACCOUNTING PRACTICE — PART I

November 2, 1983; 1:30 to 6:00 P.M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	45	55
No. 2	45	55
No. 3	45	55
No. 4	45	55
No. 5	40	50
Total	220	270

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers. Since objective items are computer-graded, your comments and calculations associated with them are not considered.

3. For problem-type questions you should enclose all scratch sheets. Failure to enclose scratch sheets may result in loss of grading points. Scratch sheets need not have page numbers, but you should show the question number and place them immediately following the question to which they relate.

4. Fourteen-column sheets, if any, should not be folded until all sheets, both wide and narrow, are placed in the proper sequence and fastened together at the top left corner. All fourteen-column sheets should then be wrapped around the back of the papers.

5. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of financial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

97. Gross billings for merchandise sold by Baker Company to its customers last year amounted to $5,260,000; sales returns and allowances reduced the amounts owed by $160,000. How much were net sales last year for Baker Company?
   a $4,800,000
   b $5,100,000
   c. $5,200,000
   d. $5,260,000

Answer Sheet

97. (a) ● (c) (d)

Items to be Answered

1. Dixon Menswear Shop regularly buys shirts from Colt Company and is allowed trade discounts of 20% and 10% from the list price. Dixon purchased shirts from Colt on May 27, 1983, and received an invoice with a list price amount of $5,000, and payment terms of 2/10, n/30. Dixon uses the net method to record purchases. Dixon should record the purchase at
   a. $3,600
   b. $3,528
   c. $3,500
   d. $3,430

2. On January 1, 1982, Hansen, Inc., issued for $939,000, one thousand of its 9%, $1,000 bonds. The bonds were issued to yield 10%. The bonds are dated January 1, 1982, and mature on December 31, 1991. Interest is payable annually on December 31. Hansen uses the interest method of amortizing bond discount. In its December 31, 1982, balance sheet, Hansen should report unamortized bond discount of
   a. $57,100
   b. $54,900
   c. $51,610
   d. $51,000

3. Moore Company carries product A in inventory on December 31, 1982, at its unit cost of $7.50. Because of a sharp decline in demand for the product, the selling price was reduced to $8.00 per unit. Moore's normal profit margin on product A is $1.60, disposal costs are $1.00 per unit, and the replacement cost is $5.30. Under the rule of cost or market, whichever is lower, Moore's December 31, 1982, inventory of product A should be valued at a unit cost of
   a. $5.30
   b. $5.40
   c. $7.00
   d. $7.50

4. Weaver Company sells magazine subscriptions for a one-year, two-year, or three-year period. Cash receipts from subscribers are credited to magazine subscriptions collected in advance, and this account had a balance of $1,700,000 at December 31, 1981. Information for the year ended December 31, 1982, is as follows:

Cash receipts from subscribers	$2,100,000
Magazine subscriptions revenue (credited at 12/31/82)	1,500,000

In its December 31, 1982, balance sheet, what amount should Weaver report as the balance for magazine subscriptions collected in advance?
   a. $1,400,000
   b. $1,900,000
   c. $2,100,000
   d. $2,300,000

5. On April 1, 1983, Girard Corporation issued at 98 plus accrued interest, two hundred of its 10%, $1,000 bonds. The bonds are dated January 1, 1983, and mature on January 1, 1993. Interest is payable semiannually on January 1 and July 1. From the bond issuance Girard would realize net cash receipts of
   a. $191,000
   b. $196,000
   c. $198,500
   d. $201,000

6. Essex Company purchased a machine on July 1, 1982, for $300,000. The machine has an estimated useful life of five years and a salvage value of $40,000. The machine is being depreciated from the date of acquisition by the 150% declining balance method. For the year ended December 31, 1982, Essex should record depreciation on this machine of
   a. $39,000
   b. $45,000
   c. $60,000
   d. $90,000

7. On January 1, 1975, Gilson Corporation issued for $1,030,000, one thousand of its 9%, $1,000 callable bonds. The bonds are dated January 1, 1975, and mature on December 31, 1989. Interest is payable semiannually on January 1 and July 1. The bonds can be called by the issuer at 102 on any interest payment date after December 31, 1979. The unamortized bond premium was $14,000 at December 31, 1982, and the market price of the bonds was 99 on this date. In its December 31, 1982, balance sheet, at what amount should Gilson report the carrying value of the bonds?

a. $1,020,000
b. $1,016,000
c. $1,014,000
d. $ 990,000

8. Scott Company filed a voluntary bankruptcy petition on June 25, 1982, and the statement of affairs reflects the following amounts:

	Book carrying amount	*Estimated current value*
Assets:		
Assets pledged with fully secured creditors	$160,000	$190,000
Assets pledged with partially secured creditors	90,000	60,000
Free assets	200,000	140,000
	$450,000	$390,000
Liabilities:		
Liabilities with priority	$ 20,000	
Fully secured creditors	130,000	
Partially secured creditors	100,000	
Unsecured creditors	260,000	
	$510,000	

Assume that the assets are converted into cash at the estimated current values and the business is liquidated. What total amount of cash should the partially secured creditors receive?

a. $ 60,000
b. $ 84,000
c. $ 90,000
d. $100,000

9. In October 1982 Ewing Company exchanged an old packaging machine, which cost $120,000 and was 50% depreciated, for a dissimilar used machine and paid a cash difference of $16,000. The market value of the old packaging machine was determined to be $70,000. For the year ended December 31, 1982, what amount of gain or loss should Ewing recognize on this exchange?

a. $0.
b. $ 6,000 loss.
c. $10,000 loss.
d. $10,000 gain.

10. Frye Company incurred research and development costs in 1982 as follows:

Equipment acquired for use in research and development projects	$1,000,000
Depreciation on the above equipment	150,000
Materials used	200,000
Compensation costs of personnel	500,000
Outside consulting fees	100,000
Indirect costs appropriately allocated	250,000

The total research and development costs charged in Frye's 1982 income statement should be

a. $ 650,000
b. $ 900,000
c. $1,200,000
d. $1,800,000

11. On July 1, 1981, Stone Company lent $120,000 to a foreign supplier, evidenced by an interest bearing note due on July 1, 1982. The note is denominated in the currency of the borrower and was equivalent to 840,000 local currency units (LCU) on the loan date. The note principal was appropriately included at $140,000 in the receivables section of Stone's December 31, 1981, balance sheet. The note principal was repaid to Stone on the July 1, 1982, due date when the exchange rate was 8 LCU to $1. In its income statement for the year ended December 31, 1982, what amount should Stone include as a foreign currency transaction gain or loss?

a. $0.
b. $15,000 loss.
c. $15,000 gain.
d. $35,000 loss.

12. On January 15, 1981, Ward Company purchased 10,000 shares (10%) of the outstanding common stock of Diamond, Inc., for $25 per share. The purchase was appropriately recorded as a long-term investment and accounted for under the cost method. The market price of the stock was $24 per share on December 31, 1981. During 1982 Diamond experienced severe financial difficulties and Ward disposed of its entire investment in Diamond stock for $10 per share on November 10, 1982. Ward's effective income tax rate was 40% for 1982. In its income statement for the year ended December 31, 1982, how much should Ward report as unusual loss from disposal of the long-term investment?

a. $150,000
b. $140,000
c. $ 90,000
d. $ 84,000

13. On May 1, 1982, the board of directors of Edgewood, Inc., approved a formal plan to sell its electronics division. The division is considered a segment of the business. It is expected that the actual sale will occur in the first three months of 1983. During 1982 the electronics division had a loss from operations of $1,200,000 which was incurred evenly during the year. Edgewood's effective tax rate for 1982 is 40%. For the year ended December 31, 1982, Edgewood should report a loss from operations of discontinued electronics division of

a. $240,000
b. $400,000
c. $480,000
d. $720,000

14. On July 1, 1982, Chatham, Inc., called for redemption all of its $1,000,000 face amount bonds payable outstanding at the call price of 105. As of June 30, 1982, the unamortized discount was $50,000 and the unamortized bond issue costs were $30,000. The market value of the bonds was $1,060,000 on July 1, 1982. Chatham's effective income tax rate was 40% for 1982. In its income statement for the year ended December 31, 1982, what amount should Chatham report as extraordinary gain or loss from bond redemption?

a. $0.
b. $30,000 gain.
c. $60,000 loss.
d. $78,000 loss.

15. Appling Company had 300,000 shares of common stock issued and outstanding at December 31, 1981. No common stock was issued during 1982. On January 1, 1982, Appling issued 200,000 shares of nonconvertible preferred stock. During 1982 Appling declared and paid $150,000 cash dividends on the common stock and $120,000 on the preferred stock. Net income for the year ended December 31, 1982, was $660,000. What should be Appling's 1982 earnings per common share?

a. $1.30
b. $1.70
c. $1.80
d. $2.20

16. Madden Company owns a tract of land which it purchased in 1980 for $100,000. The land is held as a future plant site and has a fair market value of $140,000 on July 1, 1983. Hall Company also owns a tract of land held as a future plant site. Hall paid $180,000 for the land in 1982 and the land has a fair market value of $200,000 on July 1, 1983. On this date Madden exchanged its land and paid $50,000 cash for the land owned by Hall. At what amount should Madden record the land acquired in the exchange?

a. $150,000
b. $160,000
c. $190,000
d. $200,000

17. On January 1, 1982, Nutley Corporation had monetary assets of $2,000,000 and monetary liabilities of $1,000,000. During 1982 Nutley's monetary inflows and outflows were relatively constant and equal so that it ended the year with net monetary assets of $1,000,000. Assume that the Consumer Price Index was 200 on January 1, 1982, and 220 on December 31, 1982. In end-of-year constant dollars, what is Nutley's purchasing power gain or loss on net monetary items for 1982?

a. $0.
b. $ 50,000 gain.
c. $100,000 gain.
d. $100,000 loss.

18. Selected information from the accounting records of Dalton Manufacturing Company is as follows:

Net sales for 1982	$1,800,000
Cost of goods sold for 1982	1,200,000
Inventories at December 31, 1981	336,000
Inventories at December 31, 1982	288,000

Assuming there are 300 working days per year, what is the number of days' sales in average inventories for 1982?

a. 78
b. 72
c. 52
d. 48

19. Grant, Inc., has current receivables from affiliated companies at December 31, 1982, as follows:

- A $50,000 cash advance to Adams Corporation. Grant owns 30% of the voting stock of Adams and accounts for the investment by the equity method.
- A receivable of $160,000 from Bullard Corporation for administrative and selling services. Bullard is 100% owned by Grant and is included in Grant's consolidated statements.
- A receivable of $100,000 from Carpenter Corporation for merchandise sales on open account. Carpenter is a 90% owned, unconsolidated subsidiary of Grant.

In the current assets section of its December 31, 1982, consolidated balance sheet, Grant should report accounts receivable from investees in the total amount of

a. $ 90,000
b. $140,000
c. $150,000
d. $310,000

20. On December 31, 1981, Kern Company adopted the dollar value LIFO inventory method. All of Kern's inventories constitute a single pool. The inventory on December 31, 1981, using the dollar value LIFO inventory method was $600,000. Inventory data for 1982 are as follows:

12/31/82 inventory at year-end prices	$780,000
Relevant price index at year-end (base year 1981)	120

Under the dollar value LIFO inventory method, Kern's inventory at December 31, 1982, would be

a. $650,000
b. $655,000
c. $660,000
d. $720,000

Number 2 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of financial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

21. Barrett Company's account balances at December 31, 1982, for accounts receivable and the related allowance for doubtful accounts were $1,200,000 and $60,000, respectively. An aging of accounts receivable indicated that $106,000 of the December 31, 1982, receivables may be uncollectible. The net realizable value of accounts receivable was

a. $1,034,000
b. $1,094,000
c. $1,140,000
d. $1,154,000

22. Anderson Company accepted a $20,000, 90-day, 12% interest-bearing note dated September 15, 1982, from a customer. On October 15, 1982, Anderson discounted the note at Provident National Bank at a 15% discount rate. The customer paid the note at maturity. Based on a 360-day year, what amount should Anderson report as net interest revenue from the note transaction?

a. $ 85
b. $100
c. $150
d. $200

23. On August 29, 1983, Hadley Company sustained a loss from a fire that completely destroyed a machine with a fair value of $30,000. The machine was covered by an insurance policy with a face amount of $18,000 and a coinsurance clause of 80%. How much should Hadley expect to recover from the insurance company?

a. $24,000
b. $22,500
c. $18,000
d. $14,400

24. On January 7, 1983, Dean Company discounted its own $100,000, 180-day note at United National Bank at a discount rate of 20%. Dean repaid the note on the July 6, 1983, due date. Based on a 360-day year, the effective rate of interest on the borrowing was

a. 18.2%
b. 20.0%
c. 22.2%
d. 25.0%

25. On June 30, 1982, a fire in Ruffing Company's plant caused a total loss to a production machine. The machine had a book value of $80,000 at December 31, 1981, and was being depreciated at an annual rate of $10,000. The machine had a fair value of $110,000 at the date of the fire, and Ruffing received insurance proceeds of $100,000 in October 1982. The same month Ruffing purchased a replacement machine for $130,000. Ignoring income taxes, what amount should Ruffing report on its 1982 income statement as involuntary conversion gain or loss?

a. $0.
b. $10,000 loss.
c. $20,000 gain.
d. $25,000 gain.

26. On July 1, 1982, Diamond, Inc., paid $1,000,000 for 100,000 shares (40%) of the outstanding common stock of Ashley Corporation. At that date the net assets of Ashley totaled $2,500,000 and the fair values of all of Ashley's identifiable assets and liabilities were equal to their book values. Ashley reported net income of $500,000 for the year ended December 31, 1982, of which $300,000 was for the six months ended December 31, 1982. Ashley paid cash dividends of $250,000 on September 30, 1982. In its income statement for the year ended December 31, 1982, what amount of income should Diamond report from its investment in Ashley?

a. $ 80,000
b. $100,000
c. $120,000
d. $200,000

27. On January 1, 1978, Walton Company purchased a machine for $200,000 and established an annual straight-line depreciation rate of 10%, with no salvage value. During 1982 Walton determined that the machine will not be economically useful in its production process after December 31, 1982. Walton estimated that the machine had no scrap value at December 31, 1982, and would be disposed of in early 1983 at a cost of $5,000. In its income statement for the year ended December 31, 1982, what amount(s) and type of charge(s) should Walton report for the machine?

	Depreciation expense	*Loss on abandonment*
a.	$0	$125,000
b.	$ 20,000	$100,000
c.	$ 20,000	$105,000
d.	$120,000	$ 5,000

28. Barker Company leased a new machine from Bell Company on July 1, 1983, under a lease with the following pertinent information:

Lease term	10 years
Annual rental payable at the beginning of each lease year	$30,000
Useful life of the machine	12 years
Implicit interest rate	14%
Present value of an annuity of $1 in advance for 10 periods at 14%	5.95
Present value of $1 for 10 periods at 14%	0.27

Barker has the option to purchase the machine on July 1, 1993, by paying $40,000, which approximates the expected fair value of the machine on the option exercise date. The cost of the machine on Bell's accounting records is $150,000. On July 1, 1983, Barker should record a capitalized leased asset of

a. $150,000
b. $178,500
c. $189,300
d. $190,000

29. On December 20, 1982, Sussex Corporation received a condemnation award of $300,000 as compensation for the forced sale of a company plant with a book value of $200,000. In its income tax return for the year ended December 31, 1982, Sussex elected to replace the condemned plant within the allowed replacement period. Accordingly, the $100,000 gain was not reported as taxable income for 1982. Sussex has an effective income tax rate of 40% for 1982. In its December 31, 1982, balance sheet, what amount should Sussex report as a liability for deferred taxes on the above gain?

a. $60,000
b. $40,000
c. $20,000
d. $0

30. Bronson Apparel, Inc., operates a retail store and must determine the proper December 31, 1982, year-end accrual for the following expenses:

- The store lease calls for fixed rent of $1,000 per month, payable at the beginning of the month, and additional rent equal to 6% of net sales over $200,000 per calendar year, payable on January 31 of the following year. Net sales for 1982 are $800,000.

- Bronson has personal property subject to a city property tax. The city's fiscal year runs from July 1 to June 30 and the tax, assessed at 3% of personal property on hand at April 30, is payable on June 30. Bronson estimates that its personal property tax will amount to $6,000 for the city's fiscal year ending June 30, 1983.

In its December 31, 1982, balance sheet, Bronson should report accrued expenses of

a. $39,000
b. $39,600
c. $51,000
d. $51,600

31. Martin Company began operations on January 1, 1981, and a substantial part of its sales are made on an installment basis. For financial reporting Martin recognizes revenues from all sales under the accrual method. However, on its income tax returns, Martin reports revenues from installment sales under the installment method. Information concerning gross profit from installment sales under each method is as follows:

Year	*Accrual method*	*Installment method*
1981	$400,000	$150,000
1982	650,000	350,000

For both years, assume the effective income tax rate is 40% and there are no other timing differences. In its December 31, 1982, balance sheet, Martin should report a liability for deferred taxes of

a. $220,000
b. $200,000
c. $180,000
d. $120,000

32. On December 27, 1982, Holden Company sold a building, receiving as consideration a $400,000 noninterest bearing note due in three years. The building cost $380,000 and the accumulated depreciation was $160,000 at the date of sale. The prevailing rate of interest for a note of this type was 12%. The present value of $1 for three periods at 12% is 0.71. In its 1982 income statement, how much gain or loss should Holden report on the sale?

a. $ 20,000 gain.
b. $ 64,000 gain.
c. $ 96,000 loss.
d. $180,000 gain.

33. On December 31, 1982, Jackson Company leased a new machine from Nash Corporation. The following information relates to the lease transaction:

- The machine has an estimated useful life of seven years which coincides with the lease term.
- Lease rentals consist of seven equal annual payments of $100,000, the first of which was paid on December 31, 1982.
- Nash's implicit interest rate is 12%, which is known by Jackson.
- Jackson's incremental borrowing rate is 14% at December 31, 1982.
- Present value of an annuity of $1 in advance for seven periods at 12% is 5.11.
- Present value of an annuity of $1 in advance for seven periods at 14% is 4.89.

At the inception of the lease, Jackson should record a capitalized lease liability of

a. $389,000
b. $489,000
c. $500,000
d. $511,000

34. During 1982 Peterson Company experienced financial difficulties and is likely to default on a $500,000, 15%, three-year note dated January 1, 1981, payable to Forest National Bank. On December 31, 1982, the bank agreed to settle the note and unpaid interest of $75,000 for 1982 for $50,000 cash and marketable securities having a current market value of $375,000. Peterson's acquisition cost of the securities is $385,000. Ignoring income taxes, what amount should Peterson report as a gain from the debt restructuring in its 1982 income statement?

a. $ 65,000
b. $ 75,000
c. $140,000
d. $150,000

35. Crowder Company acquired a tract of land containing an extractable natural resource. Crowder is required by the purchase contract to restore the land to a condition suitable for recreational use after it has extracted the natural resource. Geological surveys estimate that the recoverable reserves will be 5,000,000 tons, and that the land will have a value of $1,000,000 after restoration. Relevant cost information follows:

Land	$9,000,000
Estimated restoration costs	1,500,000

If Crowder maintains no inventories of extracted material, what should be the charge to depletion expense per ton of extracted material?

a. $2.10
b. $1.90
c. $1.80
d. $1.60

36. Effective with the year ended December 31, 1982, Grimm Company adopted a new accounting method for estimating the allowance for doubtful accounts at the amount indicated by the year-end aging of accounts receivable. The following data are available:

Allowance for doubtful accounts, 1/1/82	$24,000
Provision for doubtful accounts during 1982 (2% on credit sales of $1,000,000)	20,000
Bad debts written off, 11/30/82	19,500
Estimated uncollectible accounts per aging, 12/31/82	21,000

After year-end adjustment, the bad debt expense for 1982 would be

a. $16,500
b. $19,500
c. $20,000
d. $21,000

37. On January 1, 1982, Kiner Company formed a foreign branch. The branch purchased merchandise at a cost of 720,000 local currency units (LCU) on February 15, 1982. The purchase price was equivalent to $180,000 on this date. The branch's inventory at December 31, 1982, consisted solely of merchandise purchased on February 15, 1982, and amounted to 240,000 LCU. The exchange rate was 6 LCU to $1 on December 31, 1982, and the average rate of exchange was 5 LCU to $1 for 1982. Assume that the LCU is the functional currency of the branch. In Kiner's December 31, 1982, balance sheet, the branch inventory balance of 240,000 LCU should be translated into United States dollars at

a. $40,000
b. $48,000
c. $60,000
d. $84,000

38. On January 1, 1982, Chestnut Corporation adopted a noncontributory pension plan. The actuarial consultant recommended a 7% interest rate, and applying an acceptable actuarial method, determined that the past service cost is $500,000 at January 1, 1982. The normal cost will be funded fully each year and the past service cost will be amortized and funded over 20 years. Information relating to the plan for 1982 is as follows:

Normal pension cost	$100,000
Past service cost amortized and funded	47,200

In its income statement for the year ended December 31, 1982, Chestnut should report pension expense of

a. $100,000
b. $135,000
c. $147,200
d. $150,000

39. Marsh, Inc., has an incentive compensation plan under which the president is paid a bonus of 10% of corporate income in excess of $100,000 before income tax but after deducting the bonus. The 1982 income before income tax and bonus is $430,000. The bonus should be

a. $39,091
b. $36,667
c. $33,000
d. $30,000

40. Metropol Football Company had a player contract with Allen that is recorded in its books at $250,000 on July 1, 1983. Wildcat Football Company had a player contract with Baxter that is recorded in its books at $300,000 on July 1, 1983. On this date Metropol traded Allen to Wildcat for Baxter and paid a cash difference of $25,000. The fair value of the Baxter contract was $350,000 on the exchange date. After the exchange, the Baxter contract should be recorded in Metropol's books at

a. $275,000
b. $300,000
c. $325,000
d. $350,000

Number 3 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of managerial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

41. Walman Company is budgeting sales of 42,000 units of product Y for March 1983. To make one unit of finished product, three pounds of raw material A are required. Actual beginning and desired ending inventories of raw material A and product Y are as follows:

	3/1/83	*3/31/83*
Raw material A	100,000 pounds	110,000 pounds
Product Y	22,000 units	24,000 units

There is no work-in-process inventory for product Y at the beginning and end of March. For the month of March, how many pounds of raw material A is Walman planning to purchase?

a. 126,000
b. 132,000
c. 136,000
d. 142,000

42. Bolton Company produces a food product in 50 gallon batches. The basic ingredients used are material X costing $8 per gallon and material Y costing $12 per gallon. No more than 16 gallons of X can be used, and at least 18 gallons of Y must be used. How would the objec ive function (minimization of product cost) be expresse.l?

a. 8 X + 12 Y
b. 8 X + 18 Y
c. 16 X + 18 Y
d. 16 X + 34 Y

43. Regan Company operates its factory on a two-shift basis and pays a late-shift differential of 15%. Regan also pays a premium of 50% for overtime work. Since Regan manufactures only for stock, the cost system provides for uniform direct-labor hourly charges for production done without regard to shift worked or work done on an overtime basis. Overtime and late-shift differentials are included in Regan's factory overhead application rate. The May 1983 payroll for production workers is as follows:

Wages at base direct-labor rates	$325,000
Shift differentials	25,000
Overtime premiums	10,000

For the month of May 1983, what amount of direct labor should Regan charge to work-in-process?

a. $325,000
b. $335,000
c. $350,000
d. $360,000

44. Worley Company has underapplied overhead of $45,000 for the year ended December 31, 1982. Before disposition of the underapplied overhead, selected December 31, 1982, balances from Worley's accounting records are as follows:

Sales	$1,200,000
Cost of goods sold	720,000
Inventories:	
Direct materials	36,000
Work-in-process	54,000
Finished goods	90,000

Under Worley's cost accounting system, over or underapplied overhead is allocated to appropriate inventories and cost of goods sold based on year-end balances. In its 1982 income statement, Worley should report cost of goods sold of

a. $682,500
b. $684,000
c. $756,000
d. $757,500

45. Department A is the first stage of Mann Company's production cycle. The following information is available for conversion costs for the month of April 1983:

	Units
Work-in-process, beginning (60% complete)	20,000
Started in April	340,000
Completed in April and transferred to department B	320,000
Work-in-process, ending (40% complete)	40,000

Using the FIFO method, the equivalent units for the conversion cost calculation are

a. 320,000
b. 324,000
c. 336,000
d. 360,000

46. Barnett Company adds materials at the beginning of the process in department M. Conversion costs were 75% complete as to the 8,000 units in work-in-process at May 1, 1983, and 50% complete as to the 6,000 units in work-in-process at May 31. During May 12,000 units were completed and transferred to the next department. An analysis of the costs relating to work-in-process at May 1 and to production activity for May is as follows:

	Costs	
	Materials	Conversion
Work-in-process, 5/1	$ 9,600	$ 4,800
Costs added in May	15,600	14,400

Using the weighted-average method, the total cost per equivalent unit for May was

a. $2.47
b. $2.50
c. $2.68
d. $3.16

47. Geyer Company uses a standard cost system. For the month of April 1983, total overhead is budgeted at $80,000 based on the normal capacity of 20,000 direct-labor hours. At standard each unit of finished product requires 2 direct-labor hours. The following data are available for the April 1983 production activity:

Equivalent units of product	9,500
Direct-labor hours worked	19,500
Actual total overhead incurred	$79,500

What amount should Geyer credit to the applied factory overhead account for the month of April 1983?

a. $76,000
b. $78,000
c. $79,500
d. $80,000

48. Information on Cox Company's direct-material costs for the month of January 1983 was as follows:

Actual quantity purchased	18,000
Actual unit purchase price	$ 3.60
Materials purchase price variance—unfavorable (based on purchases)	$ 3,600
Standard quantity allowed for actual production	16,000
Actual quantity used	15,000

For January 1983 there was a favorable direct-material usage variance of

a. $3,360
b. $3,375
c. $3,400
d. $3,800

49. Harper Company uses a standard cost system. Data relating to direct labor for the month of August 1983 is as follows:

Direct-labor efficiency variance—favorable	$5,250
Standard direct-labor rate	$ 7.00
Actual direct-labor rate	$ 7.50
Standard hours allowed for actual production	9,000

What are the actual hours worked for the month of August 1983?

a. 9,750
b. 8,400
c. 8,300
d. 8,250

50. The manufacturing capacity of Jordan Company's facilities is 30,000 units of product a year. A summary of operating results for the year ended December 31, 1982, is as follows:

Sales (18,000 units @ $100)	$1,800,000
Variable manufacturing and selling costs	990,000
Contribution margin	810,000
Fixed costs	495,000
Operating income	$ 315,000

A foreign distributor has offered to buy 15,000 units at $90 per unit during 1983. Assume that all of Jordan's costs would be at the same levels and rates in 1983 as in 1982. If Jordan accepted this offer and rejected some business from regular customers so as not to exceed capacity, what would be the total operating income for 1983?

a. $390,000
b. $705,000
c. $840,000
d. $855,000

Items 51 and 52 are based on the following information:

Grafton Company produces joint products A and B in department One from a process which also yields by-product W. Product A and by-product W are sold after separation, but product B must be further processed in department Two before it can be sold. The cost assigned to the by-product is its market value less $0.40 per pound for delivery expense (net realizable value method). Information relating to a batch produced in July 1983 is as follows:

Product	Production (in pounds)	Sales price per pound
A	2,000	$4.50
B	4,000	9.00
W	500	1.50

Joint cost in department One	$18,000
Product B additional process cost in department Two	$10,000

51. For joint cost allocation purposes, what is the net realizable value at the split-off point of product B?
   a. $46,000
   b. $45,000
   c. $36,000
   d. $26,000

52. How much of the joint cost incurred in department One should be allocated to the joint products?
   a. $17,250
   b. $17,450
   c. $17,800
   d. $18,550

53. Barclay Company sells 20,000 pocket calculators evenly throughout the year. The cost of carrying one unit in inventory for one year is $4 and the purchase order cost per order is $64. What is the economic order quantity?
   a. 400
   b. 566
   c. 800
   d. 1,250

54. During March 1983 Hart Company incurred the following costs on Job 109 for the manufacture of 200 motors:

Original cost accumulation:	
Direct materials	$ 660
Direct labor	800
Factory overhead (150% of direct labor)	1,200
	$2,660
Direct costs of reworking 10 units:	
Direct materials	$100
Direct labor	160
	$260

The rework costs were attributable to exacting specifications of Job 109 and the full rework costs were charged to this specific job. The cost per finished unit of Job 109 was
   a. $15.80
   b. $14.60
   c. $14.00
   d. $13.30

55. In preparing its cash budget for July 1983, Reed Company made the following projections:

Sales	$1,500,000
Gross profit (based on sales)	25%
Decrease in inventories	$ 70,000
Decrease in accounts payable for inventories	$ 120,000

For July 1983 what were the estimated cash disbursements for inventories?
   a. $ 935,000
   b. $1,050,000
   c. $1,055,000
   d. $1,175,000

56. Fawcett Company uses a flexible budget system and prepared the following information for 1982:

	Normal capacity	Maximum capacity
Percent of capacity	80%	100%
Direct-labor hours	32,000	40,000
Variable factory overhead	$ 64,000	$ 80,000
Fixed factory overhead	$160,000	$160,000
Total factory overhead rate per direct-labor hour	$7	$6

Fawcett operated at 90% of capacity during 1982. The actual factory overhead for 1982 was $252,000. What was the budget (controllable) overhead variance for the year?
   a. $36,000 unfavorable.
   b. $20,000 unfavorable.
   c. $18,000 unfavorable.
   d. $0.

Items 57 and 58 are based on the following information:

Ajax Division of Carlyle Corporation produces electric motors, 20% of which are sold to Bradley Division of Carlyle and the remainder to outside customers. Carlyle treats its divisions as profit centers and allows division managers to choose their sources of sale and supply. Corporate policy requires that all interdivisional sales and purchases be recorded at variable cost as a transfer price. Ajax Division's estimated sales and standard cost data for the year ending December 31, 1982, based on the full capacity of 100,000 units, are as follows:

	Bradley	*Outsiders*
Sales	$ 900,000	$ 8,000,000
Variable costs	(900,000)	(3,600,000)
Fixed costs	(300,000)	(1,200,000)
Gross margin	$(300,000)	$ 3,200,000
Unit sales	20,000	80,000

Ajax has an opportunity to sell the above 20,000 units to an outside customer at a price of $75 per unit during 1982 on a continuing basis. Bradley can purchase its requirements from an outside supplier at a price of $85 per unit.

57. Assuming that Ajax Division desires to maximize its gross margin, should Ajax take on the new customer and drop its sales to Bradley for 1982, and why?
  a. No, because the gross margin of the corporation as a whole would decrease by $200,000.
  b. Yes, because Ajax Division's gross margin would increase by $300,000.
  c. Yes, because Ajax Division's gross margin would increase by $600,000.
  d. No, because Bradley Division's gross margin would decrease by $800,000.

58. Assume, instead, that Carlyle permits the division managers to negotiate the transfer price for 1982. The managers agreed on a tentative transfer price of $75 per unit, to be reduced based on an equal sharing of the additional gross margin to Ajax resulting from the sale to Bradley of 20,000 motors at $75 per unit. The actual transfer price for 1982 would be
  a. $52.50
  b. $55.00
  c. $60.00
  d. $67.50

59. Rice Corporation currently operates two divisions which had operating results for the year ended December 31, 1982, as follows:

	West Division	*Troy Division*
Sales	$600,000	$300,000
Variable costs	310,000	200,000
Contribution margin	290,000	100,000
Fixed costs for the Division	110,000	70,000
Margin over direct costs	180,000	30,000
Allocated corporate costs	90,000	45,000
Operating income (loss)	$ 90,000	$(15,000)

Since the Troy Division also sustained an operating loss during 1981, Rice's president is considering the elimination of this division. Assume that the Troy Division fixed costs could be avoided if the division were eliminated. If the Troy Division had been eliminated on January 1, 1982, Rice Corporation's 1982 operating income would have been
  a. $15,000 higher.
  b. $30,000 lower.
  c. $45,000 lower.
  d. $60,000 higher.

60. Gandy Company is considering a proposal to introduce a new product, RLX. An outside marketing consultant prepared the following payoff probability distribution describing the relative likelihood of monthly sales volume levels and related income (loss) for RLX:

Monthly sales volume	*Probability*	*Income (loss)*
6,000	0.10	$(70,000)
12,000	0.20	10,000
18,000	0.40	60,000
24,000	0.20	100,000
30,000	0.10	140,000

The expected value of the monthly income from RLX is
  a. $ 48,000
  b. $ 53,000
  c. $ 60,000
  d. $240,000

Number 4 (Estimated time —— 45 to 55 minutes)

Ashwood, Inc., is a public enterprise whose shares are traded in the over-the-counter market. At December 31, 1981, Ashwood had 6,000,000 authorized shares of $10 par value common stock, of which 2,000,000 shares were issued and outstanding. The stockholders' equity accounts at December 31, 1981, had the following balances:

Common stock	$20,000,000
Additional paid-in capital	7,500,000
Retained earnings	6,500,000

Transactions during 1982 and other information relating to the stockholders' equity accounts were as follows:

- On January 5, 1982, Ashwood issued at $54 per share, 100,000 shares of $50 par value, 9% cumulative convertible preferred stock. Each share of preferred stock is convertible, at the option of the holder, into two shares of common stock. Ashwood had 600,000 authorized shares of preferred stock. The preferred stock has a liquidation value equal to its par value.
- On February 1, 1982, Ashwood reacquired 20,000 shares of its common stock for $16 per share. Ashwood uses the cost method to account for treasury stock.
- On April 30, 1982, Ashwood sold 500,000 shares (previously unissued) of $10 par value common stock to the public at $17 per share.
- On June 18, 1982, Ashwood declared a cash dividend of $1 per share of common stock, payable on July 12, 1982, to stockholders of record on July 1, 1982.
- On November 10, 1982, Ashwood sold 10,000 shares of treasury stock for $21 per share.
- On December 14, 1982, Ashwood declared the yearly cash dividend on preferred stock, payable on January 14, 1983, to stockholders of record on December 31, 1982.
- On January 20, 1983, before the books were closed for 1982, Ashwood became aware that the ending inventories at December 31, 1981, were understated by $300,000 (after tax effect on 1981 net income was $180,000). The appropriate correction entry was recorded the same day.
- After correcting the beginning inventory, net income for 1982 was $4,500,000.

Required (show supporting computations in good form):

1. Prepare a statement of retained earnings for the year ended December 31, 1982. Assume that only single-period financial statements for 1982 are presented.
2. Prepare the stockholders' equity section of Ashwood's balance sheet at December 31, 1982.
3. Compute the book value per share of common stock at December 31, 1982.

Number 5 (Estimated time —— 40 to 50 minutes)

Amboy Corporation acquired all of the outstanding $10 par voting common stock of Taft, Inc., on January 1, 1982, in exchange for 50,000 shares of its $10 par voting common stock. On December 31, 1981, Amboy's common stock had a closing market price of $15 per share on a national stock exchange. The acquisition was appropriately accounted for as a purchase. Both companies continued to operate as separate business entities maintaining separate accounting records with years ending December 31.

On December 31, 1982, after year-end adjustments but before the nominal accounts were closed, the companies had condensed general ledger trial balances as follows:

	Amboy Dr. (Cr.)	*Taft* Dr. (Cr.)
Net sales	$(1,900,000)	$(1,500,000)
Dividend income from Taft, Inc.	(40,000)	
Gain on sale of warehouse	(30,000)	
Cost of goods sold	1,180,000	870,000
Operating expenses (includes depreciation)	550,000	440,000
Cash	285,000	150,000
Accounts receivable (net)	430,000	350,000
Inventories	530,000	410,000
Land, plant & equipment	660,000	680,000
Accumulated depreciation	(185,000)	(210,000)
Investment in Taft, Inc. (at cost)	750,000	
Accounts payable & accrued expenses	(670,000)	(594,000)
Common stock ($10 par)	(1,200,000)	(400,000)
Additional paid-in capital	(140,000)	(80,000)
Retained earnings (1/1/82)	(220,000)	(156,000)
Dividends paid		40,000
Total	$ 0	$ 0

Additional information is as follows:

- There were no changes in the common stock and additional paid-in capital accounts during 1982 except the one necessitated by Amboy's acquisition of Taft.
- At the acquisition date the current value of Taft's machinery exceeded its book value by $54,000. The excess will be amortized over the estimated average remaining life of six years. The fair values of all of Taft's other assets and liabilities were equal to their book values. Any goodwill resulting from the acquisition will be amortized over a 20-year period.
- On July 1, 1982, Amboy sold a warehouse facility to Taft for $129,000 cash. At the date of sale Amboy's book values were $33,000 for the land and $66,000 for the undepreciated cost of the building. Taft allocated the $129,000 purchase price to the land for $43,000 and to the building for $86,000. Taft is depreciating the building over its estimated five-year remaining useful life by the straight-line method with no salvage value.
- During 1982 Amboy purchased merchandise from Taft at an aggregate invoice price of $180,000, which included a 100% markup on Taft's cost. At December 31, 1982, Amboy owed Taft $75,000 on these purchases, and $36,000 of the merchandise purchased remained in Amboy's inventory.

Required:

Complete the tear-out worksheet to prepare a consolidated income statement and retained earnings statement for the year ended December 31, 1982, and a consolidated balance sheet as at December 31, 1982, for Amboy Corporation and its subsidiary, Taft, Inc. Formal consolidated statements and journal entries are not required. Ignore income tax considerations. Supporting computations should be in good form. Include the completed tear-out worksheet in the proper sequence and turn in with other answer sheets.

Uniform Certified Public Accountant Examination
Accounting Practice——Part I
November 1983

Candidate's No. ____________
State ____________
Question No. __5__ **Page** ________

Amboy Corporation and Subsidiary
CONSOLIDATING STATEMENT WORKSHEET
December 31, 1982

Income Statement	*Amboy Corp.*	*Taft Inc.*	*Adjustments & Eliminations* Debit	*Adjustments & Eliminations* Credit	*Adjusted Balance*
Net sales	$(1,900,000)	$(1,500,000)			
Dividends from Taft	(40,000)				
Gain on sale of warehouse	(30,000)				
Cost of goods sold	1,180,000	870,000			
Operating expenses (incl. deprec.)	550,000	440,000			
Net income	$ (240,000)	$ (190,000)			
Retained Earnings Statement					
Balance, 1/1/82	$ (220,000)	$ (156,000)			
Net income	(240,000)	(190,000)			
Dividends paid		40,000			
Balance, 12/31/82	$ (460,000)	$ (306,000)			
Balance Sheet					
Assets:					
Cash	$ 285,000	$ 150,000			
Accounts receivable (net)	430,000	350,000			
Inventories	530,000	410,000			
Land, plant & equipment	660,000	680,000			
Accumulated depreciation	(185,000)	(210,000)			
Investment in Taft (at cost)	750,000				
	$ 2,470,000	$ 1,380,000			
Liabilities & Stockholders' Equity:					
Accounts pay. & accrued exp.	$ (670,000)	$ (594,000)			
Common stock ($10 par)	(1,200,000)	(400,000)			
Additional paid-in capital	(140,000)	(80,000)			
Retained Earnings	(460,000)	(306,000)			
	$(2,470,000)	$(1,380,000)			

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN ACCOUNTING PRACTICE — PART II

November 3, 1983; 1:30 to 6:00 P.M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	45	55
No. 2	45	55
No. 3	45	55
No. 4	45	55
No. 5	40	50
Total	220	270

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers. Since objective items are computer-graded, your comments and calculations associated with them are not considered.

3. For problem-type questions you should enclose all scratch sheets. Failure to enclose scratch sheets may result in loss of grading points. Scratch sheets need not have page numbers, but you should show the question number and place them immediately following the question to which they relate.

4. Fourteen-column sheets, if any, should not be folded until all sheets, both wide and narrow, are placed in the proper sequence and fastened together at the top left corner. All fourteen-column sheets should then be wrapped around the back of the papers.

5. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of financial and managerial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

97. Gross billings for merchandise sold by Baker Company to its customers last year amounted to $5,260,000; sales returns and allowances reduced the amounts owed by $160,000. How much were net sales last year for Baker Company?
    a. $4,800,000
    b. $5,100,000
    c. $5,200,000
    d. $5,260,000

Answer Sheet

97. (a) ● (c) (d)

Items to be Answered

1. In January 1983 Lee Corp. paid property taxes of $40,000 covering the calendar year 1983. Also in January 1983, Lee estimated that its year-end bonuses to executives would amount to $160,000 for 1983. What is the total amount of expense relating to these two items that should be reflected in Lee's quarterly income statement for the three months ended June 30, 1983?
    a. $0
    b. $10,000
    c. $40,000
    d. $50,000

2. Adams Construction Co. uses the percentage-of-completion method of accounting. During 1982, Adams contracted to build an apartment house for Roper for $10,000,000. Adams estimated that total costs would amount to $8,000,000 over the period of construction. In connection with this contract, Adams incurred $1,000,000 of construction costs during 1982. Adams billed and collected $1,500,000 from Roper in 1982. How much gross profit should Adams recognize in 1982?
    a. $300,000
    b. $250,000
    c. $187,500
    d. $125,000

3. All of Rolf Co.'s employees are entitled to two weeks of paid vacation for each full year in Rolf's employ. Unused vacation time can be accumulated and carried forward to succeeding years, and will be compensated at the salary in effect when the vacation is taken. Mary Beal started her employment with Rolf on January 1, 1976. As of December 31, 1982, when Beal's salary was $500 per week, Beal had used ten weeks of her accumulated vacation time. In December 1982, Beal notified Rolf of Beal's intention to use her accumulated vacation weeks in June 1983. Rolf regularly scheduled salary adjustments in July of each year. Rolf properly did not deduct compensation for unused vacations in Rolf's 1982 income tax return. How much should Rolf report as a liability at December 31, 1982, for Beal's accumulated vacation time?
    a. $0
    b. $ 500
    c. $1,000
    d. $2,000

4. Kee Co. has five manufacturing divisions, each of which has been determined to be a reportable segment. Common costs are appropriately allocated on the basis of each division's sales in relation to Kee's aggregate sales. Kee's Sigma division comprised 40% of Kee's total sales in 1982. For the year ended December 31, 1982, Sigma had sales of $1,000,000 and traceable costs of $600,000. In 1982 Kee incurred operating expenses of $100,000 that were not directly traceable to any of the five divisions. In addition, Kee incurred interest expense of $80,000 in 1982. In reporting supplementary segment information, how much should be shown as Sigma's operating income for 1982?
    a. $300,000
    b. $328,000
    c. $360,000
    d. $400,000

5. Balan Co.'s pricing structure has been formulated to yield a gross margin of 40%. The following data pertain to the year ended December 31, 1982:

Sales	$600,000
Beginning inventory	100,000
Purchases	400,000
Physical inventory at year-end	100,000

Balan is satisfied that all sales and purchases have been fully and properly recorded. How much might Balan reasonably estimate as missing inventory at December 31, 1982?
    a. $0
    b. $ 40,000
    c. $140,000
    d. $160,000

6. The following information pertains to a property dividend of marketable securities, declared by Tyson Corp.:

	Fair value
Declaration date—December 20, 1982	$300,000
Record date—January 10, 1983	310,000
Distribution date—January 28, 1983	305,000

Carrying value of the securities on Tyson's books was $200,000. How much gain should Tyson recognize in 1982 as a result of this property dividend?
   a. $0
   b. $100,000
   c. $105,000
   d. $110,000

7. Patel Co. bought a patent for $300,000 on January 2, 1979, at which time the patent had an estimated useful life of 10 years. On February 2, 1982, it was determined that this patent's useful life would expire at the end of 1985. How much should Patel record as amortization expense for this patent for the year ending December 31, 1983?
   a. $70,000
   b. $60,000
   c. $52,500
   d. $30,000

8. Agard Company's effective income tax rate is 40%. For the year ended December 31, 1982, Agard's income statement reflected depletion expense of $1,000,000 based on the cost of assets being depleted. However, Agard properly deducted $4,000,000 for percentage depletion on its 1982 tax return. How much should be reported as provision for deferred income taxes in Agard's 1982 financial statements?
   a. $1,600,000
   b. $1,200,000
   c. $ 400,000
   d. $0

9. Andan Corp. purchased machinery in 1982 that qualified for an investment tax credit of $10,000. This machinery is being depreciated over a five-year period. Andan's 1982 taxable income and book income before income taxes, was $250,000. Andan's effective income tax rate for 1982 was 40%. If Andan accounts for the investment tax credit by the flow-through method, how much should Andan report in its 1982 income statement for income tax expense?
   a. $ 90,000
   b. $ 96,000
   c. $ 98,000
   d. $100,000

Items 10 and 11 are based on the following data:

Kalik Co. sells radios for $60 each. Variable expenses are $40 per unit, while fixed expenses total $30,000.

10. How many radios must Kalik sell to earn an operating income of $70,000?
   a. 5,000
   b. 3,500
   c. 2,500
   d. 1,500

11. What total dollar amount must Kalik sell to break even?
   a. $ 40,000
   b. $ 75,000
   c. $ 90,000
   d. $120,000

---

12. Koby Co. has sales of $200,000 with variable expenses of $150,000, fixed expenses of $60,000, and an operating loss of $10,000. By how much would Koby have to increase its sales in order to achieve an operating income of 10% of sales?
   a. $400,000
   b. $251,000
   c. $231,000
   d. $200,000

Items 13 and 14 are based on the following data:

The following selected data pertain to the belt division of Allen Corp. for 1982:

Sales	$2,000,000
Average invested capital	500,000
Operating income	300,000
Capital turnover	4.0
Imputed interest rate	18%

13. How much is the return on investment?
   a. 60%
   b. 33%
   c. 18%
   d. 15%

14. How much is the residual income?
   a. $0
   b. $200,000
   c. $210,000
   d. $246,000

Items 15 and 16 are based on the following data:

Bates Co. incurred the following costs:

Direct materials and direct labor	$600,000
Variable factory overhead	80,000
Straight-line depreciation:	
Production machinery	70,000
Factory building	50,000

15. Under absorption costing, the inventoriable costs are
    a. $680,000
    b. $730,000
    c. $750,000
    d. $800,000

16. Under variable (direct) costing, the inventoriable costs are
    a. $600,000
    b. $680,000
    c. $720,000
    d. $750,000

Items 17 and 18 are based on the following data:

Amaro Hospital, a nonprofit institution not subject to income taxes, is considering the purchase of new equipment costing $20,000, in order to achieve cash savings of $5,000 per year in operating costs. The equipment's estimated useful life is ten years, with no net residual value. Amaro's cost of capital is 14%. For ten periods at 14%, the present value of $1 is 0.270, while the present value of an ordinary annuity of $1 is 5.216.

17. What factor contained in or developed from the above information should be used in computing the internal rate of return for Amaro's proposed investment in the new equipment?
    a. 5.216
    b. 4.000
    c. 1.400
    d. 0.270

18. How much is the accounting rate of return based on Amaro's initial investment in the new equipment?
    a. 27%
    b. 25%
    c. 15%
    d. 14%

19. Barr Corporation's capital stock at December 31, 1982, consisted of the following:

Common stock, $2 par value; 100,000 shares authorized, issued, and outstanding

10% noncumulative, nonconvertible preferred stock, $100 par value; 1,000 shares authorized, issued, and outstanding

Barr's common stock, which is listed on a major stock exchange, was quoted at $4 per share on December 31, 1982. Barr's net income for the year ended December 31, 1982, was $50,000. The 1982 preferred dividend was declared. No capital stock transactions occurred during 1982. What was the price-earnings ratio on Barr's common stock at December 31, 1982?
    a. 8 to 1.
    b. 10 to 1.
    c. 16 to 1.
    d. 20 to 1.

20. Ace Company's working capital at December 31, 1981, was $5,000,000. The following additional information pertains to Ace for 1982:

Working capital provided by operations	$ 850,000
Capital expenditures	1,500,000
Short-term borrowings	500,000
Long-term borrowings	1,000,000
Payments on short-term borrowings	250,000
Payments on long-term borrowings	300,000
Proceeds from issuance of common stock	700,000
Dividends paid on common stock	400,000

How much was Ace's working capital at December 31, 1982?
    a. $5,350,000
    b. $5,600,000
    c. $5,750,000
    d. $6,000,000

Number 2 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **the federal income taxation of individuals.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **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. Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

21. Don Mott was the sole proprietor of a high-volume drug store which he owned for 15 years before he sold it to Dale Drug Stores, Inc., in 1982. Besides the $900,000 selling price for the store's tangible assets and goodwill, Mott received a lump sum of $30,000 in 1982 for his agreement not to operate a competing enterprise within ten miles of the store's location, for a period of six years. The $30,000 will be taxed to Mott as
   a. $30,000 ordinary income in 1982.
   b. $30,000 short-term capital gain in 1982.
   c. $30,000 long-term capital gain in 1982.
   d. Ordinary income of $5,000 a year for six years.

22. Al Daly's adjusted gross income for the year ended December 31, 1982, was $20,000. He was not covered under any medical insurance plan. During 1982, he paid $500 to a physician for treatment of a heart condition. He also owed the physician a balance of $900 for an operation performed in December 1982, which he paid in January 1983. In addition, Daly incurred a $1,700 hospital bill in 1982, which he charged to his bank credit card in December 1982 and paid to the bank in January 1983. Daly's total allowable medical deduction for 1982 is
   a. $0
   b. $ 500
   c. $1,600
   d. $2,500

23. Alex Kerr was 65 years old on January 21, 1983, and has been legally blind for the past three years. Alex's wife, Rose, lived with him until her death on January 5, 1982, at the age of 50. Rose had no income of her own. Alex did not remarry in 1982. How many personal exemptions was Alex entitled to on his 1982 income tax return?
   a. One
   b. Two
   c. Three
   d. Four

24. Jill Nolan's filing status for 1982 was that of a single individual. Jill claimed itemized deductions of $5,000 on her 1982 income tax return. How much was Jill's zero bracket amount for 1982?
   a. $1,700
   b. $2,300
   c. $2,700
   d. $3,400

25. Mr. & Mrs. John Hance jointly gave a $100,000 outright gift in 1982 to an unrelated friend, Fred Green, who needed the money to pay medical expenses. In filing their gift tax returns for 1982, Mr. & Mrs. Hance were entitled to exclusions aggregating
   a. $0
   b. $ 6,000
   c. $10,000
   d. $20,000

26. In 1970, Edwin Ryan bought 100 shares of a listed stock for $5,000. In June 1982, when the stock's fair market value was $7,000, Edwin gave this stock to his sister, Lynn. No gift tax was paid. Lynn died in October 1982, bequeathing this stock to Edwin, when the stock's fair market value was $9,000. Lynn's executor did not elect the alternate valuation. What is Edwin's basis for this stock after he inherits it from Lynn's estate?
   a. $0
   b. $5,000
   c. $7,000
   d. $9,000

27. Martin Rowe died on January 5, 1982, bequeathing his entire $1,000,000 estate to his brother, Art. The alternate valuation date was elected by the executor of Martin's estate, and the estate tax return was timely filed. Martin's estate included 1,000 shares of a listed stock for which Martin's basis was $190,000. This stock was distributed to Art nine months after Martin's death. Fair market values of this stock were as follows:

As of the date of Martin's death	$200,000
Six months after Martin's death	225,000
Nine months after Martin's death	240,000

What is Art's basis for this stock?
   a. $190,000
   b. $200,000
   c. $225,000
   d. $240,000

28. In January 1979, Melvin Axel bought 100 shares of a listed stock for $4,000. In March 1980, when the fair market value was $3,000, Melvin gave this stock to his cousin, Ellen. No gift tax was paid. Ellen sold this stock in June 1982 for $3,500. How much is Ellen's reportable gain or loss in 1982 on the sale of this stock?
   a. $0.
   b. $ 500 loss.
   c. $ 500 gain.
   d. $3,500 gain.

29. Mr. & Mrs. Ben Bornn adopted a child in 1983. The child qualified for adoption assistance payments under the Social Security Act. In connection with the adoption, Bornn paid court costs and legal fees aggregating $1,600. These expenses were considered reasonable and were not reimbursed to Bornn. If Mr. and Mrs. Bornn itemize their deductions on their 1983 return, how much will they be permitted to deduct for adoption expenses?
   a. $0
   b. $1,000
   c. $1,500
   d. $1,600

Items 30 through 32 are based on the following data:

Frank Lyon, who itemized his deductions on his 1982 income tax return, paid the following unreimbursed expenses in 1982:

Realty taxes on the house in which he resides with his dependent mother; the house is owned by his mother	$3,000
State and city gasoline taxes	100
Physical examination required by Frank's employer	200
Meals in connection with overtime work	180

In addition, Frank was held up and robbed of $800 cash in June 1982. One month later, Frank had $2,000 cash stolen from him by his housekeeper.

30. How much of the realty and gasoline taxes should be included in Frank's itemized deductions in 1982?
   a. $0
   b. $ 100
   c. $3,000
   d. $3,100

31. How much was deductible by Frank as employee business expenses for 1982?
   a. $0
   b. $180
   c. $200
   d. $380

32. How much was deductible by Frank for theft losses in 1982?
   a. $1,900
   b. $2,600
   c. $2,700
   d. $2,800

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33. In June 1982, Olive Bell bought a house for use partially as a residence and partially for operation of a retail gift shop. In addition, Olive bought the following furniture:

Kitchen set and living room pieces for the residential portion	$ 8,000
Showcases and tables for the business portion	12,000

How much of this furniture comprises capital assets?
   a. $0
   b. $ 8,000
   c. $12,000
   d. $20,000

34. In 1981, Max Bayne filed a joint return with his wife, Lois, and excluded $400 of interest earned on an all-savers certificate held in Max's name alone. In 1982, Max and Lois were divorced. Neither spouse remarried in 1982. In 1982, Max received interest of $1,000 on his all-savers certificate. How much of this $1,000 interest could Max exclude in 1982?
   a. $1,000
   b. $ 800
   c. $ 700
   d. $ 600

35. Mr. and Mrs. Carl Nido own 5,000 shares of common stock of Niagara Power Corporation, a qualified domestic public utility. Instead of receiving their dividends in cash on the Niagara stock, the Nidos have elected to receive common stock under Niagara's qualified dividend reinvestment plan. The Nidos earned $2,000 in dividends on their Niagara stock in 1982. What portion of these dividends could the Nidos exclude from gross dividend income (before other allowable dividend exclusions) on their 1982 joint return?
   a. $2,000
   b. $1,800
   c. $1,500
   d. $0

36. Dr. Berger, a physician, reports on the cash basis. The following items pertain to Dr. Berger's medical practice in 1982:

Cash received from patients in 1982	$200,000
Cash received in 1982 from third-party reimbursers for services provided by Dr. Berger in 1981	30,000
Salaries paid to employees in 1982	20,000
Year-end 1982 bonuses paid to employees in 1983	1,000
Other expenses paid in 1982	24,000

What is Dr. Berger's net income for 1982 from his medical practice?
   a. $155,000
   b. $156,000
   c. $185,000
   d. $186,000

37. Morris Babb, CPA, reports on the cash basis. In March 1983, Babb billed a client $1,000 for accounting services rendered in connection with the client's divorce settlement. No part of the $1,000 fee was ever paid. In July 1983, the client went bankrupt and the $1,000 obligation became totally worthless. What loss can Babb deduct on his 1983 tax return?
   a. $0.
   b. $1,000 short-term capital loss.
   c. $1,000 business bad debt.
   d. $1,000 nonbusiness bad debt.

38. Fred Bly, who is single and does not qualify as head of a household, had taxable income of $40,000 for 1982, exclusive of capital gains and losses. After offsetting capital gains, Bly had a net short-term capital loss of $5,000 for 1982. How much of this net short-term capital loss can Bly offset against his ordinary income for 1982?
   a. $1,000
   b. $1,500
   c. $3,000
   d. $5,000

39. An office building owned by Elmer Bass was condemned by the state on January 2, 1982. Bass received the condemnation award on March 1, 1983. In order to qualify for nonrecognition of gain on this involuntary conversion, what is the last date for Bass to acquire qualified replacement property?
   a. August 1, 1984.
   b. January 2, 1985.
   c. March 1, 1986.
   d. December 31, 1986.

40. Ernest Sosa files a joint return with his wife. Sosa's employer pays 100% of the cost of all employees' group-term life insurance under a qualified plan. What is the maximum amount of tax-free coverage that may be provided for Sosa by his employer under this plan?
   a. $ 5,000
   b. $ 10,000
   c. $ 50,000
   d. $100,000

Number 3 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **the federal income taxation of corporations and partnerships.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **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. Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

41. Luba Corp. was organized in 1983 with the intention of operating as an S corporation (Subchapter S). What is the maximum number of stockholders allowable for eligibility as an S corporation (Subchapter S)?
   a. 35
   b. 15
   c. 9
   d. 5

42. On December 31, 1981, Edward Baker gave his son, Allan, a gift of a 50% interest in a partnership in which capital is a material income-producing factor. For the year ended December 31, 1982, the partnership's ordinary income was $100,000. Edward and Allan were the only partners in 1982. There were no guaranteed payments to partners. Edward's services performed for the partnership were worth a reasonable compensation of $40,000 for 1982. Allan has never performed any services for the partnership. What is Allan's distributive share of partnership income for 1982?
   a. $20,000
   b. $30,000
   c. $40,000
   d. $50,000

43. Pym Corp. received the following dividends in 1982:

From a mutual savings bank	$1,000
From an unaffiliated domestic taxable corporation	5,000

How much of these dividends qualifies for the 85% dividends-received deduction?
   a. $0
   b. $1,000
   c. $5,000
   d. $6,000

44. Yuki Corp., which began business in 1982, incurred the following costs in 1982 in connection with organizing the corporation:

Printing of stock certificates	$ 5,000
Underwriters' commissions on sale of stock	100,000

What portion of these costs qualifies as amortizable organization expenses deductible ratably over a period of not less than 60 months?
   a. $105,000
   b. $100,000
   c. $ 5,000
   d. $0

45. For the year ended December 31, 1982, Seco Corp. had an operating income of $9,500. In addition, Seco had the following capital gains and losses:

Net short-term capital gain	$1,000
Net long-term capital loss	9,000

How much of the excess of net long-term capital loss over net short-term capital gain could Seco offset against ordinary income in 1982?
   a. $0
   b. $3,000
   c. $3,500
   d. $8,000

46. Which of the following is **not** a requirement for a corporation to elect S corporation status (Subchapter S)?
   a. Must be a member of a controlled group.
   b. Must confine stockholders to individuals, estates, and certain qualifying trusts.
   c. Must be a domestic corporation.
   d. Must have only one class of stock.

47. For the year ended December 31, 1982, Haya Corp. had gross business income of $600,000 and expenses of $800,000. Contributions of $5,000 to qualified charities were included in expenses. In addition to the expenses, Haya had a net operating loss carryover of $9,000. What was Haya's net operating loss for 1982?
   a. $209,000
   b. $204,000
   c. $200,000
   d. $195,000

Items 48 and 49 are based on the following data:

Nilo Corp., a restaurant, commenced operations on January 1, 1982. For the year ended December 31, 1982, Nilo incurred a net operating loss of $100,000. In addition, Nilo had a net capital loss of $7,000 in 1982 from the sale of stock of an unrelated company.

48. What is the maximum carryover period for Nilo's 1982 net operating loss?
   a. 15 years.
   b. 7 years.
   c. 5 years.
   d. 3 years.

49. What is the maximum carryover period for Nilo's 1982 net capital loss?
   a. 3 years.
   b. 5 years.
   c. 8 years.
   d. Indefinite, until used.

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50. When Kile Corp. was organized in 1975, it received $100,000 from the sale of 10,000 shares of its $10 par value common stock. In 1980, Kile reacquired 300 of these shares as treasury stock, at a cost of $6,000. In 1983, Kile sold the 300 shares of treasury stock to an unrelated party for $7,500. How much capital gain should Kile report in its 1983 tax return in connection with the sale of these 300 shares?
   a. $4,500
   b. $3,000
   c. $1,500
   d. $0

51. At January 1, 1983, Pearl Corp. owned 90% of the outstanding stock of Seso Corp. Both companies were domestic corporations. Pursuant to a plan of liquidation adopted by Seso in March 1983, Seso distributed all of its property in September 1983, in complete redemption of all its stock, when Seso's accumulated earnings equalled $18,000. Seso had never been insolvent. Pursuant to the liquidation, Seso transferred to Pearl a parcel of land with a basis of $10,000 and a fair market value of $40,000. How much gain must Seso recognize in 1983 on the transfer of this land to Pearl?
   a. $0
   b. $18,000
   c. $27,000
   d. $30,000

52. In computing the ordinary income of a partnership, a deduction is allowed for
   a. The net operating loss deduction.
   b. Contributions to recognized charities.
   c. Partners' personal exemptions.
   d. Guaranteed payments to partners.

53. Harry Arch, an attorney, rendered legal services in organizing an oil and gas partnership in 1983. Instead of submitting a bill for his services, Arch accepted a 10% interest in the partnership. Arch's normal charge for the services performed would have been $10,000. The fair market value of the 10% interest received by Arch was $12,000. How much should Arch report on his 1983 income tax return?
   a. $12,000
   b. $10,000
   c. $ 2,000
   d. $0

54. Ralph Elin contributed a plot of land to the partnership of Anduz & Elin. Elin's adjusted basis for this land was $50,000, and its fair market value was $75,000. Under the partnership agreement, Elin's capital account was credited with the full fair market value of the land. Anduz matched Elin's contribution with a $75,000 cash contribution to the partnership. Thus, each partner's capital account was credited with $75,000. Elin and Anduz share profits and losses equally. What is the adjusted basis of Elin's interest in the partnership?
   a. $25,000
   b. $37,500
   c. $50,000
   d. $75,000

55. Orna Corp., a calendar-year taxpayer, had an unused investment credit of $8,000 at December 31, 1982, its first taxable year. For how many years can Orna carry over this unused investment credit?
   a. 15
   b. 7
   c. 5
   d. 3

Items 56 and 57 are based on the following statements which pertain *either* to the accumulated earnings tax, *or* to the personal holding company tax, *or* to both:

(1) Imposition of the tax depends on a stock ownership test specified in the statute.

(2) Imposition of the tax can be mitigated by sufficient dividend distributions.

(3) The tax should be self-assessed by filing a separate schedule along with the regular tax return.

56. Which of the foregoing statements pertain to the accumulated earnings tax?
   a. (1) only.
   b. (2) only.
   c. (3) only.
   d. (1), (2), and (3).

57. Which of the foregoing statements pertain to the personal holding company tax?
   a. (1) only.
   b. (2) only.
   c. (3) only.
   d. (1), (2), and (3).

58. Magda Shaw's adjusted basis for her partnership interest in Shaw & Zack was $60,000. In complete liquidation of her interest in Shaw & Zack, Shaw received cash of $44,000 plus the following assets:

	Adjusted basis to Shaw & Zack
Land — Tract "A"	$24,000
Land — Tract "B"	8,000

How much is Shaw's basis for Tract "B"?
   a. $16,000
   b. $15,000
   c. $ 8,000
   d. $ 4,000

59. During the 1982 holiday season, Palo Corp. gave business gifts to 17 customers. These gifts, which were not of an advertising nature, had the following fair market values:

4 @ $ 10
4 @ 25
4 @ 50
5 @ 100

How much of these gifts was deductible as a business expense for 1982?
   a. $840
   b. $365
   c. $140
   d. $0

60. Lara Corporation's stock is owned by Toty, Inc., a Delaware corporation. At December 31, 1982, the close of Lara's taxable year, Lara had earnings and profits of $90,000. In December 1982, Lara made a distribution of land to Toty. Lara's adjusted basis for this land was $25,000, while the land's fair market value at the date of distribution was $40,000. Lara had no recognized gain or loss on this property distribution. How much of this property distribution should be treated as a dividend in 1982?
   a. $0
   b. $15,000
   c. $25,000
   d. $40,000

Number 4 (Estimated time —— 45 to 55 minutes)

A partial balance sheet of Rapapo State University as of the end of its fiscal year ended July 31, 1982, is presented below.

Rapapo State University
CURRENT FUNDS BALANCE SHEET
July 31, 1982

Assets		*Liabilities and Fund Balances*	
Unrestricted:		Unrestricted:	
Cash	$200,000	Accounts payable	$100,000
Accounts receivable—tuition and fees, less allowance for doubtful accounts of $15,000	360,000	Due to other funds	40,000
		Deferred revenue—tuition and fees	25,000
		Fund balance	435,000
Prepaid expenses	40,000		
Total unrestricted	600,000	Total unrestricted	600,000
Restricted:		Restricted:	
Cash	10,000	Accounts payable	5,000
Investments	210,000	Fund balance	215,000
Total restricted	220,000	Total restricted	220,000
Total current funds	$820,000	Total current funds	$820,000

The following information pertains to the year ended July 31, 1983:

1. Cash collected from students' tuition totaled $3,000,000. Of this $3,000,000, $362,000 represented accounts receivable outstanding at July 31, 1982; $2,500,000 was for current year tuition; and $138,000 was for tuition applicable to the semester beginning in August 1983.

2. Deferred revenue at July 31, 1982 was earned during the year ended July 31, 1983.

3. Accounts receivable at July 31, 1982, which were not collected during the year ended July 31, 1983, were determined to be uncollectible and were written off against the allowance account. At July 31, 1983, the allowance account was estimated at $10,000.

4. During the year, an unrestricted appropriation of $60,000 was made by the state. This state appropriation was to be paid to Rapapo sometime in August 1983.

5. During the year, unrestricted cash gifts of $80,000 were received from alumni. Rapapo's board of trustees allocated $30,000 of these gifts to the student loan fund.

6. During the year, investments costing $25,000 were sold for $31,000. Restricted fund investments were purchased at a cost of $40,000. Investment income of $18,000 was earned and collected during the year.

7. Unrestricted general expenses of $2,500,000 were recorded in the voucher system. At July 31, 1983, the unrestricted accounts payable balance was $75,000.

8. The restricted accounts payable balance at July 31, 1982 was paid.

9. The $40,000 due to other funds at July 31, 1982 was paid to the plant fund as required.

10. One quarter of the prepaid expenses at July 31, 1982 expired during the current year, and pertained to general education expense. There was no addition to prepaid expenses during the year.

Required:

a. Prepare journal entries in summary form to record the foregoing transactions for the year ended July 31, 1983. Number each entry to correspond with the number indicated in the description of its respective transaction. Your answer sheet should be organized as follows:

		Current Funds			
		Unrestricted		*Restricted*	
Entry no.	*Accounts*	*Debit*	*Credit*	*Debit*	*Credit*

b. Prepare a statement of changes in fund balances for the year ended July 31, 1983.

Number 5 (Estimated time —— 40 to 50 minutes)

At December 31, 1982, Winsor Corp. properly reported as current assets the following marketable equity securities:

Bea Corp., 1,000 shares, $2.40 convertible preferred stock	$ 40,000
Cha, Inc., 6,000 shares of common stock	60,000
Dey Co., 2,000 shares of common stock	55,000
Marketable equity securities at cost	$155,000
Less valuation allowance	7,000
Marketable equity securities at market	$148,000

On January 2, 1983, Winsor purchased 100,000 shares of Eddie Corp. common stock for $1,700,000, representing 30% of Eddie's outstanding common stock and an underlying equity of $1,400,000 in Eddie's net assets at January 2. Winsor, which had no other financial transactions with Eddie during 1983, amortizes goodwill over a 40-year period. As a result of Winsor's 30% ownership of Eddie, Winsor has the ability to exercise significant influence over Eddie's financial and operating policies.

During 1983, Winsor disposed of the following securities:

- January 18 — sold 2,500 shares of Cha for $13 per share.
- June 1 — sold 500 shares of Dey, after a 10% stock dividend, for $21 per share.
- October 1 — converted 500 shares of Bea's preferred stock into 1,500 shares of Bea's common stock, when the market price was $60 per share for the preferred stock and $21 per share for the common stock.

The following 1983 dividend information pertains to the stock held by Winsor:

- February 14 — Dey issued a 10% stock dividend, when the market price of Dey's common stock was $22 per share.
- April 5 and October 5 — Bea paid dividends of $1.20 per share on its $2.40 preferred stock, to stockholders of record on March 9 and September 9, respectively. Bea did not pay any dividends on its common stock during 1983.
- June 30 — Cha paid a $1.00 per share dividend on its common stock.
- March 1, June 1, September 1, and December 1 — Eddie paid quarterly dividends of $0.50 per share on each of these dates. Eddie's net income for the year ended December 31, 1983, was $1,200,000.

At December 31, 1983, Winsor's management intended to hold the Eddie stock as a long-term investment, with the remaining investments being considered as temporary. Market prices per share of the marketable equity securities were as follows:

	At December 31,	
	1983	*1982*
Bea Corp. — preferred	$56	$42
Bea Corp. — common	20	18
Cha, Inc. — common	11	11
Dey Co. — common	22	20
Eddie Corp. — common	16	18

All of the foregoing stocks are listed on major stock exchanges. Declines in market value from cost would not be considered as permanent declines.

Required:

a. Prepare a schedule of Winsor's *current* marketable equity securities at December 31, 1983, including any information necessary to determine the related valuation allowance and unrealized gross gains and losses.

b. Prepare a schedule to show the carrying amount of Winsor's *noncurrent* marketable equity securities at December 31, 1983.

c. Prepare a schedule showing all income, gains, and losses (realized and unrealized) relating to Winsor's investments, for the year ended December 31, 1983.

EXAMINATION IN AUDITING

November 3, 1983; 8:30 A.M. to 12:00 M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	90	110
No. 2	15	25
No. 3	15	25
No. 4	15	25
No. 5	15	25
Total	150	210

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers.

3. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 90 to 110 minutes)

Instructions

Select the **best** answer for each of the following items. Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet would be marked:

Item

96. One of the generally accepted auditing standards specifies that the auditor should
    a. Inspect all fixed assets acquired during the year.
    b. Charge fair fees based on cost.
    c. Make a proper study and evaluation of the existing internal control.
    d. Count client petty-cash funds.

Answer Sheet

96. (a) (b) ● (d)

Items to be Answered

1. Which one of the following would require a consistency modification in the auditor's report?
    a. Changing the salvage value of an asset.
    b. Changing the presentation of prepaid insurance from inclusion in "other assets" to disclosing it as a separate line item.
    c. Division of the consolidated subsidiary into two subsidiaries which are both consolidated.
    d. Changing from consolidating a wholly-owned subsidiary to carrying it on the equity basis.

2. Which of the following is **not** a typical analytical review procedure?
    a. Study of relationships of financial information with relevant nonfinancial information.
    b. Comparison of financial information with similar information regarding the industry in which the entity operates.
    c. Comparison of recorded amounts of major disbursements with appropriate invoices.
    d. Comparison of recorded amounts of major disbursements with budgeted amounts.

3. The machine language for a specific computer
    a. May be changed by the programmer.
    b. Is the same as all other computer languages.
    c. Is determined by the engineers who designed the computer.
    d. Is always alphabetic.

4. Hitech, Inc., has changed from a conventional to a computerized payroll clock card system. Factory employees now record time in and out with magnetic cards and the EDP system automatically updates all payroll records. Because of this change
    a. The auditor must audit through the computer.
    b. Internal control has improved.
    c. Part of the audit trail has been lost.
    d. The potential for payroll related fraud has been diminished.

5. When an auditor selects a sample of items from the vouchers payable register for the last month of the period under audit and traces these items to underlying documents, the auditor is gathering evidence primarily in support of the assertion that
    a. Recorded obligations were paid.
    b. Incurred obligations were recorded in the correct period.
    c. Recorded obligations were valid.
    d. Cash disbursements were recorded as incurred obligations.

6. From the auditor's point of view, inventory counts are more acceptable prior to the year end when
    a. Internal control is weak.
    b. Accurate perpetual inventory records are maintained.
    c. Inventory is slow-moving.
    d. Significant amounts of inventory are held on a consignment basis.

7. Which of the following is an element of sampling risk?
    a. Choosing an audit procedure that is inconsistent with the audit objective.
    b. Choosing a sample size that is too small to achieve the sampling objective.
    c. Failing to detect an error on a document that has been inspected by the auditor.
    d. Failing to perform audit procedures that are required by the sampling plan.

8. The application of statistical sampling techniques is **least** related to which of the following generally accepted auditing standards?
    a. The work is to be adequately planned and assistants, if any, are to be properly supervised.
    b. In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.
    c. There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.
    d. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.

9. Given random selection, the same sample size, and the same precision requirement for the testing of two unequal populations, the risk of overreliance on the smaller population is
   a. Higher than the risk of overreliance on the larger population.
   b. Lower than the risk of overreliance on the larger population.
   c. The same as the risk of overreliance on the larger population.
   d. Indeterminable relative to the risk of overreliance on the larger population.

10. Compliance testing is performed in order to determine whether or not
   a. Controls are functioning as designed.
   b. Necessary controls are absent.
   c. Incompatible functions exist.
   d. Material dollar errors exist.

11. Pursuant to the AICPA's statements on responsibilities in tax practice, which of the following is **not** an acceptable manner of designating that an estimated figure was used in preparing a federal income tax return?
   a. Use a round amount.
   b. State expressly that an amount has been estimated.
   c. Use an amount suggested in a treasury department guideline.
   d. Modify the tax preparer's declaration on the return before signing the tax return.

12. If the achieved precision range of a statistical sample at a given reliability level is greater than the desired range this is an indication that the
   a. Standard deviation was larger than expected.
   b. Standard deviation was less than expected.
   c. Population was larger than expected.
   d. Population was smaller than expected.

13. In the application of statistical techniques to the estimation of dollar amounts, a preliminary sample is usually taken primarily for the purpose of estimating the population
   a. Variability.
   b. Mode.
   c. Range.
   d. Median.

14. Purchase cut-off procedures should be designed to test whether or not all inventory
   a. Purchased and received before the year end was recorded.
   b. On the year end balance sheet was carried at lower of cost or market.
   c. On the year end balance sheet was paid for by the company.
   d. Owned by the company is in the possession of the company.

15. For good internal control, which of the following functions should **not** be the responsibility of the treasurer's department?
   a. Data processing.
   b. Handling of cash.
   c. Custody of securities.
   d. Establishing credit policies.

16. The first standard of reporting requires that, "the report shall state whether the financial statements are presented in accordance with generally accepted accounting principles." This should be construed to require
   a. A statement of fact by the auditor.
   b. An opinion by the auditor.
   c. An implied measure of fairness.
   d. An objective measure of compliance.

17. An auditor refers to significant related party transactions in a middle paragraph of the report. If the ensuing opinion paragraph contains the words, "with the foregoing explanation," the auditor's report would be considered a(n)
   a. Unqualified opinion with appropriate reference to the middle paragraph.
   b. Example of inappropriate reporting.
   c. Adverse opinion.
   d. Negative assurance opinion.

18. If management refuses to furnish certain written representations that the auditor believes are essential, which of the following is appropriate?
   a. The auditor can rely on oral evidence relating to the matter as a basis for an unqualified opinion.
   b. The client's refusal does **not** constitute a scope limitation that may lead to a modification of the opinion.
   c. This may have an effect on the auditor's ability to rely on other representations of management.
   d. The auditor should issue an adverse opinion because of management's refusal.

19. Competence as a certified public accountant includes all of the following **except**
   a. Having the technical qualifications to perform an engagement.
   b. Possessing the ability to supervise and evaluate the quality of staff work.
   c. Warranting the infallibility of the work performed.
   d. Consulting others if additional technical information is needed.

20. Unrecorded liabilities are most likely to be found during the review of which of the following documents?
   a. Unpaid bills.
   b. Shipping records.
   c. Bills of lading.
   d. Unmatched sales invoices.

21. Which of the following is likely to be of **least** importance to an auditor in reviewing the internal control in a company with automated data processing?
  a. The segregation of duties within the EDP center.
  b. The control over source documents.
  c. The documentation maintained for accounting applications.
  d. The cost/benefit ratio of data processing operations.

22. In the weekly computer run to prepare payroll checks, a check was printed for an employee who had been terminated the previous week. Which of the following controls, if properly utilized, would have been most effective in preventing the error or ensuring its prompt detection?
  a. A control total for hours worked, prepared from time cards collected by the timekeeping department.
  b. Requiring the treasurer's office to account for the numbers of the prenumbered checks issued to the EDP department for the processing of the payroll.
  c. Use of a check digit for employee numbers.
  d. Use of a header label for the payroll input sheet.

23. Which of the following statements regarding the examination of negotiable notes receivable is correct?
  a. Confirmation from the customer of a note is **not** an acceptable alternative to inspection.
  b. Notes receivable discounted without recourse are confirmed via the standard bank confirmation form used in the audit of cash.
  c. Physical inspection of a note by the auditor provides conclusive evidence.
  d. Notes receivable discounted with recourse need **not** be confirmed.

24. An auditor confirms a representative number of open accounts receivable as of December 31, 1982, and investigates respondents' exceptions and comments. By this procedure the auditor would be most likely to learn of which of the following?
  a. One of the cashiers has been covering a personal embezzlement by lapping.
  b. One of the sales clerks has **not** been preparing charge slips for credit sales to family and friends.
  c. One of the EDP control clerks has been removing all sales invoices applicable to his account from the data file.
  d. The credit manager has misappropriated remittances from customers whose accounts have been written off.

25. During the process of confirming receivables as of December 31, 1982, a positive confirmation was returned indicating the "balance owed as of December 31 was paid on January 9, 1983". The auditor would most likely
  a. Determine whether there were any changes in the account between January 1 and January 9, 1983.
  b. Determine whether a customary trade discount was taken by the customer.
  c. Reconfirm the zero balance as of January 10, 1983.
  d. Verify that the amount was received.

26. Raider, Inc. uses the last-in, first-out method of valuation for half of its inventory and the first-in, first-out method of valuation for the other half of its inventory. Assuming the auditor is satisfied in all other respects, under these circumstances the auditor will issue a(n)
  a. Opinion modified due to inconsistency.
  b. Unqualified opinion with an explanatory middle paragraph.
  c. Qualified or adverse opinion depending upon materiality.
  d. Unqualified opinion.

27. Auditing by testing the input and output of an EDP system instead of the computer program itself will
  a. Not detect program errors which do **not** show up in the output sampled.
  b. Detect all program errors, regardless of the nature of the output.
  c. Provide the auditor with the same type of evidence.
  d. Not provide the auditor with confidence in the results of the auditing procedures.

28. Apex Incorporated issued common stock to acquire another company, in an acquisition that was accounted for as a pooling of interests. The auditor examining this transaction would be **least** interested in ascertaining
  a. The net book value of the acquired company.
  b. The par value of the stock that was issued.
  c. Whether or **not** the acquisition was approved by the board of directors of Apex Incorporated.
  d. Whether the fair market value of the acquired assets were independently appraised.

29. A financial forecast is an estimate of financial position, results of operations, and changes in financial position that, to the best of management's knowledge, is
  a. At the midpoint of a given precision range.
  b. At the low point of a given precision range.
  c. Conservative.
  d. Most probable.

30. During a review of the financial statements of a nonpublic entity, the CPA finds that the financial statements contain a material departure from generally accepted accounting principles. If management refuses to correct the financial statement presentations, the CPA should
   a. Disclose the departure in a separate paragraph of the report.
   b. Issue an adverse opinion.
   c. Attach a footnote explaining the effects of the departure.
   d. Issue a compilation report.

31. Which of the following will **not** result in modification of the auditor's report due to a scope limitation?
   a. Restrictions imposed by the client.
   b. Reliance placed on the report of another auditor.
   c. Inability to obtain sufficient competent evidential matter.
   d. Inadequacy in the accounting records.

32. An auditor examining inventory may appropriately apply sampling for attributes in order to estimate the
   a. Average price of inventory items.
   b. Percentage of slow-moving inventory items.
   c. Dollar value of inventory.
   d. Physical quantity of inventory items.

33. Which of the following procedures is **not** included in a review engagement of a nonpublic entity?
   a. Inquiries of management.
   b. Inquiries regarding events subsequent to the balance sheet date.
   c. Any procedures designed to identify relationships among data that appear to be unusual.
   d. A study and evaluation of internal control.

34. A CPA's study and evaluation of the system of internal accounting control in an audit
   a. Is generally more limited than that made in connection with an engagement to express an opinion on the system of internal accounting control.
   b. Is generally more extensive than that made in connection with an engagement to express an opinion on the system of internal accounting control.
   c. Will generally be identical to that made in connection with an engagement to express an opinion on the system of internal accounting control.
   d. Will generally result in the CPA expressing an opinion on the system of internal accounting control.

35. Which of the following **best** describes how the detailed audit program of the CPA who is engaged to audit the financial statements of a large publicly held company compares with the audit client's comprehensive internal audit program?
   a. The comprehensive internal audit program is more detailed and covers areas that would normally **not** be reviewed by the CPA.
   b. The comprehensive internal audit program is more detailed although it covers less areas than would normally be covered by the CPA.
   c. The comprehensive internal audit program is substantially identical to the audit program used by the CPA because both review substantially identical areas.
   d. The comprehensive internal audit program is less detailed and covers less areas than would normally be reviewed by the CPA.

36. Which of the following ultimately determines the specific audit procedures necessary to provide an independent auditor with a reasonable basis for the expression of an opinion?
   a. The audit program.
   b. The auditor's judgment.
   c. Generally accepted auditing standards.
   d. The auditor's working papers.

37. Whenever special reports, filed on a printed form designed by authorities, call upon the independent auditor to make an assertion that the auditor believes is **not** justified, the auditor should
   a. Reword the form or attach a separate report.
   b. Submit a short-form report with explanations.
   c. Submit the form with questionable items clearly omitted.
   d. Withdraw from the engagement.

38. The **least** crucial element of internal control over cash is
   a. Separation of cash record keeping from custody of cash.
   b. Preparation of the monthly bank reconciliation.
   c. Batch processing of checks.
   d. Separation of cash receipts from cash disbursements.

39. Which of the following would **not** necessarily be a related party transaction?
   a. Sales to another corporation with a similar name.
   b. Purchases from another corporation that is controlled by the corporation's chief stockholder.
   c. Loan from the corporation to a major stockholder.
   d. Sale of land to the corporation by the spouse of a director.

40. Which of the following situations would **most** likely require special audit planning by the auditor?
   a. Some items of factory and office equipment do **not** bear identification numbers.
   b. Depreciation methods used on the client's tax return differ from those used on the books.
   c. Assets costing less than $500 are expensed even though the expected life exceeds one year.
   d. Inventory is comprised of precious stones.

41. When testing a computerized accounting system, which of the following is **not** true of the test data approach?
   a. Test data are processed by the client's computer programs under the auditor's control.
   b. The test data must consist of all possible valid and invalid conditions.
   c. The test data need consist of only those valid and invalid conditions in which the auditor is interested.
   d. Only one transaction of each type need be tested.

42. Which of the following internal control features would an auditor be **least** likely to review?
   a. Segregation of the asset-handling and record-keeping functions.
   b. Company policy regarding credit and collection efforts.
   c. Sales and cost records classified by products.
   d. Authorization of additions to plant and equipment.

43. In the evaluation of internal accounting control, the auditor is basically concerned that the system provides reasonable assurance that
   a. Controls have **not** been circumvented by collusion.
   b. Errors have been prevented or detected.
   c. Operational efficiency has been achieved in accordance with management plans.
   d. Management can **not** override the system.

44. If an illegal act is discovered during the audit of a publicly held company, the auditor should
   a. Notify the regulatory authorities.
   b. Determine who was responsible for the illegal act.
   c. Intensify the examination.
   d. Report the act to high level personnel within the client's organization.

45. In the examination of property, plant, and equipment, the auditor tries to determine all of the following **except** the
   a. Adequacy of internal control.
   b. Extent of property abandoned during the year.
   c. Adequacy of replacement funds.
   d. Reasonableness of the depreciation.

46. The AICPA Rules of Conduct will ordinarily be considered to have been violated when the CPA represents that specific consulting services will be performed for a stated fee and it is apparent at the time of the representation that the
   a. Actual fee would be substantially higher.
   b. Actual fee would be substantially lower than the fees charged by other CPAs for comparable services.
   c. Fee was a competitive bid.
   d. CPA would **not** be independent.

47. Which of the following **best** describes the primary purpose of audit procedures?
   a. To detect error or irregularities.
   b. To comply with generally accepted accounting principles.
   c. To gather corroborative evidence.
   d. To verify the accuracy of account balances.

48. In connection with the element of inspection, a CPA firm's system of quality control should ordinarily provide for the maintenance of
   a. A file of minutes of staff meetings.
   b. Updated personnel files.
   c. Documentation to demonstrate compliance with its policies and procedures.
   d. Documentation to demonstrate compliance with peer review directives.

49. A management advisory service consultation, as opposed to a management advisory service engagement, generally involves advice or information given by a CPA that is based upon
   a. Existing personal knowledge about the client.
   b. An analytical approach and process.
   c. Information obtained during an examination of the client's financial statements.
   d. The results of an operational audit.

50. The auditor is most likely to presume that a high risk of a defalcation exists if
   a. The client is a multinational company that does business in numerous foreign countries.
   b. The client does business with several related parties.
   c. Inadequate segregation of duties places an employee in a position to perpetrate and conceal thefts.
   d. Inadequate employee training results in lengthy EDP exception reports each month.

51. An auditor will ordinarily examine invoices from lawyers primarily in order to
   a. Substantiate accruals.
   b. Assess the legal ramifications of litigation in progress.
   c. Estimate the dollar amount of contingent liabilities.
   d. Identify possible unasserted litigation, claims, and assessments.

52. Which of the following statements regarding auditor documentation of the client's system of internal control is correct?
   a. Documentation must include flow charts.
   b. Documentation must include procedural write-ups.
   c. No documentation is necessary although it is desirable.
   d. No one particular form of documentation is necessary, and the extent of documentation may vary.

53. Jones, CPA, prepared Smith's 1982 federal income tax return and appropriately signed the preparer's declaration. Several months later Jones learns that Smith improperly altered several figures before mailing the tax return to the IRS. Jones should communicate disapproval of this action to Smith and
   a. Take no further action with respect to the 1982 tax return but consider the implications of Smith's actions upon any future relationship.
   b. Inform the IRS of the unauthorized alteration.
   c. File an amended tax return.
   d. Refund any fee collected, return all relevant documents, and refuse any further association with Smith.

54. The objective of the consistency standard is to provide assurance that
   a. There are **no** variations in the format and presentation of financial statements.
   b. Substantially different transactions and events are **not** accounted for on an identical basis.
   c. The auditor is consulted before material changes are made in the application of accounting principles.
   d. The comparability of financial statements between periods is **not** materially affected by changes in accounting principles without disclosure.

55. An auditor is about to commence a recurring annual audit engagement. The continuing auditor's independence would ordinarily be considered to be impaired if the prior year's audit fee
   a. Was only partially paid and the balance is being disputed.
   b. Has **not** been paid and will **not** be paid for at least twelve months.
   c. Has **not** been paid and the client has filed a voluntary petition for bankruptcy.
   d. Was settled by litigation.

56. A CPA's license to practice will ordinarily be suspended or revoked automatically for
   a. Committing an act discreditable to the profession.
   b. Conviction of willful failure to file personal income tax returns.
   c. Refusing to respond to an inquiry by the AICPA practice review committee.
   d. Accepting compensation while honoring a subpoena to appear as an expert witness.

57. If a complete set of financial statements is presented on a comparative basis for two years, the auditor's opinion as it applies to the results of operations and changes in financial position would contain which of the following phrases?
   a. The two years then ended.
   b. The years then ended.
   c. Each of the two years ended.
   d. Each of the years in the two year period ended.

58. An auditor's report contains the following sentences:

We did not examine the financial statements of B Company, a consolidated subsidiary, which statements reflect total assets and revenues constituting 20 percent and 22 percent, respectively, of the related consolidated totals. These statements were examined by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for B Company, is based solely upon the report of the other auditors.

These sentences
   a. Disclaim an opinion.
   b. Qualify the opinion.
   c. Divide responsibility.
   d. Are an improper form of reporting.

59. After issuance of the auditor's report, the auditor has **no** obligation to make any further inquiries with respect to audited financial statements covered by an auditor's report unless a
   a. Contingency is resolved.
   b. Development occurs which may affect the client's ability to continue as a going concern.
   c. Material defalcation ensues.
   d. History of significant non-arms-length related party transactions is discovered.

60. If the auditor considers an illegal act to be sufficiently serious to warrant withdrawing from the engagement, then the auditor should
   a. Notify all parties who may rely upon the company's financial statements of the company's illegal act.
   b. Consult with legal counsel as to what other action, if any, should be taken.
   c. Return all incriminating evidence and working papers to the client's audit committee for follow-up.
   d. Contact the successor auditor to make the successor aware of the possible consequences of relying on management's representations.

Number 2 (Estimated time —— 15 to 25 minutes)

Properly designed and utilized forms facilitate adherence to prescribed internal accounting control policies and procedures. One such form might be a multicopy purchase order, with one copy intended to be mailed to the vendor. The remaining copies would ordinarily be distributed to the stores, purchasing, receiving and accounting departments.

The following purchase order is currently being used by National Industrial Corporation:

PURCHASE ORDER

SEND INVOICE ONLY TO:

297 HARDINGTEN DR., BX., NY 10461

TO ____________________ **SHIP TO** ____________________

____________________ ____________________

____________________ ____________________

DATE TO BE SHIPPED	SHIP VIA	DISC. TERMS	FREIGHT TERMS	ADV. ALLOWANCE	SPECIAL ALLOWANCE

QUANTITY	DESCRIPTION

PURCHASE CONDITIONS

1. Supplier will be responsible for extra freight cost on partial shipment, unless prior permission is obtained.
2. Please acknowledge this order.
3. Please notify us immediately if you are unable to complete order.
4. All items must be individually packed.

Required:

a. In addition to the name of the company, what other necessary information would an auditor recommend be included in the illustrative purchase order?

b. What primary internal control functions are served by the purchase order copies that are distributed to the stores, purchasing, receiving and accounting departments?

Number 3 (Estimated time —— 15 to 25 minutes)

Ross, Sandler & Co., CPAs, completed an examination of the 1982 financial statements of Fairfax Corporation on March 17, 1983, and concluded that an unqualified opinion was warranted. Because of a scope limitation arising from the inability to observe the January 1, 1981 inventory, the predecessor auditors, Smith, Ellis & Co., issued a report which contained an unqualified opinion on the December 31, 1981 balance sheet and a qualified opinion with respect to the statements of income, retained earnings, and changes in financial position for the year then ended.

The management of Fairfax Corporation has decided to present a complete set of comparative (1982 and 1981) financial statements in their annual report.

Required:

Prepare an auditor's report assuming the March 1, 1982 auditor's report of Smith, Ellis & Co. is not presented.

Number 4 (Estimated time —— 15 to 25 minutes)

Taylor, CPA, is engaged in the audit of Rex Wholesaling for the year ended December 31, 1982. Taylor performed a proper study of the system of internal accounting control relating to the purchasing, receiving, trade accounts payable and cash disbursement cycles and has decided not to proceed with compliance testing. Based upon analytical review procedures Taylor believes that the trade accounts payable balance on the balance sheet as of December 31, 1982, may be understated.

Taylor requested and obtained a client-prepared trade accounts payable schedule listing the total amount owed to each vendor.

Required:

What additional substantive audit procedures should Taylor apply in examining the trade accounts payable?

Number 5 (Estimated time —— 15 to 25 minutes)

Kent, CPA, who is engaged in the audit of the financial statements of Bass Corporation for the year ended December 31, 1982, is about to commence an audit of the noncurrent investment securities. Bass' records indicate that the company owns various bearer bonds, as well as 25% of the outstanding common stock of Commercial Industrial Inc. Kent is satisfied with evidence that supports the presumption of significant influence over Commercial Industrial Inc. The various securities are at two locations as follows:

- Recently acquired securities are in the company's safe in the custody of the treasurer.

- All other securities are in the company's bank safe deposit box.

All of the securities in Bass' portfolio are actively traded in a broad market.

Required:

a. Assuming that the system of internal control over securities is satisfactory and may be relied upon, what are the objectives of the examination of these noncurrent investment securities?

b. What audit procedures should be undertaken by Kent with respect to the examination of Bass' noncurrent investment securities?

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN BUSINESS LAW

(Commercial Law)

November 4, 1983; 8:30 A.M. to 12:00 M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Estimated Minutes* *Maximum*
No. 1	110	130
No. 2	15	20
No. 3	15	20
No. 4	15	20
No. 5	15	20
Total	170	210

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers.

3. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 110 to 130 minutes)

Instructions

Select the **best** answer for each of the following items. Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

99. The text of the letter from Bridge Builders, Inc., to Allied Steel Co. follows:

> We offer to purchase 10,000 tons of No. 4 steel pipe at today's quoted price for delivery two months from today. Your acceptance must be received in five days.

Bridge Builders intended to create a (an)

a. Option contract.
b. Unilateral contract.
c. Bilateral contract.
d. Joint contract.

Answer Sheet

99. ⓐ ⓑ ● ⓓ

Items to be Answered

1. Locke, CPA, was engaged by Hall, Inc., to audit Willow Company. Hall purchased Willow after receiving Willow's audited financial statements, which included Locke's unqualified auditor's opinion. Locke was negligent in the performance of the Willow audit engagement. As a result of Locke's negligence, Hall suffered damages of $75,000. Hall appears to have grounds to sue Locke for

	Breach of contract	*Negligence*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

2. In which of the following statements concerning a CPA firm's action is scienter or its equivalent absent?

a. Reckless disregard for the truth.
b. Actual knowledge of fraud.
c. Intent to gain monetarily by concealing fraud.
d. Performance of substandard auditing procedures.

3. Gleam is contemplating a common law action against Moore & Co., CPAs, based upon fraud. Gleam loaned money to Lilly & Company relying upon Lilly's financial statements which were audited by Moore. Gleam's action will fail if

a. Gleam shows only that Moore failed to meticulously follow GAAP.
b. Moore can establish that they fully complied with the statute of frauds.
c. The alleged fraud was in part committed by oral misrepresentations and Moore pleads the parol evidence rule.
d. Gleam is **not** a third party beneficiary in light of the absence of privity.

4. In an action for negligence against a CPA, "the custom of the profession" standard is used at least to some extent in determining whether the CPA is negligent. Which of the following statements describes how this standard is applied?

a. If the CPA proves he literally followed GAAP and GAAS, it will be conclusively presumed that the CPA was **not** negligent.
b. The custom of the profession argument may only be raised by the defendant.
c. Despite a CPA's adherence to the custom of the profession, negligence may nevertheless be present.
d. Failure to satisfy the custom of the profession is equivalent to gross negligence.

5. Lewis & Clark, CPAs, rendered an unqualified opinion on the financial statements of a company that sold common stock in a public offering subject to the Securities Act of 1933. Based on a false statement in the financial statements, Lewis & Clark are being sued by an investor who purchased shares of this public offering. Which of the following represents a viable defense?

a. The investor has **not** met the burden of proving fraud or negligence by Lewis & Clark.
b. The investor did **not** actually rely upon the false statement.
c. Detection of the false statement by Lewis & Clark occurred after their examination date.
d. The false statement is immaterial in the overall context of the financial statements.

6. The Internal Revenue Code provisions dealing with tax return preparation

a. Require tax return preparers who are neither attorneys nor CPAs to pass a basic qualifying examination.
b. Apply to all tax return preparers whether they are compensated or uncompensated.
c. Apply to a CPA who prepares the tax returns of the president of a corporation the CPA audits, without charging the president.
d. Only apply to preparers of individual tax returns.

7. Georges, a CPA, has prepared a tax return for his client, Arbor. The return was prepared in a fraudulent manner. Regarding Georges' potential liability to various parties, which of the following would be dismissed?
   a. A federal criminal action.
   b. A federal action for civil penalties.
   c. A federal action to revoke Georges' CPA certificate.
   d. A malpractice action by the client.

8. Gibson is suing Simpson & Sloan, CPAs, to recover losses incurred in connection with Gibson's transactions in Zebra Corporation securities. Zebra's Annual Form 10-K Report contained material false and misleading statements in the financial statements audited by Simpson & Sloan. To recover under the Securities and Exchange Act of 1934, Gibson must, among other things, establish that
   a. All of his past transactions in Zebra securities, both before and after the auditors' report date, resulted in a net loss.
   b. The transaction in Zebra securities that resulted in a loss occurred within 90 days of the auditors' report date.
   c. He relied upon the financial statements in his decision to purchase or sell Zebra securities.
   d. The market price of the stock dropped significantly after corrected financial statements were issued by Zebra.

9. With respect to privileged communications of accountants, which of the following is correct?
   a. A state statutory privilege will be recognized in a case being tried in a federal court involving a federal question.
   b. Most courts recognize a common-law privilege between an accountant and the client.
   c. As a result of legislative enactment and court adoption, the client-accountant privilege is recognized in the majority of jurisdictions.
   d. The privilege will be lost if the party asserting the privilege voluntarily submits part of the privileged communications into evidence.

10. Working papers prepared by a CPA in connection with an audit engagement are owned by the CPA, subject to certain limitations. The rationale for this rule is to
   a. Protect the working papers from being subpoenaed.
   b. Provide the basis for excluding admission of the working papers as evidence because of the privileged communication rule.
   c. Provide the CPA with evidence and documentation which may be helpful in the event of a lawsuit.
   d. Establish a continuity of relationship with the client whereby indiscriminate replacement of CPAs is discouraged.

11. Dixon Sales, Inc., dismissed Crow as its general sales agent. Dixon notified all of Crow's known customers by letter. Hale Stores, a retail outlet located outside of Crow's previously assigned sales territory, had never dealt with Crow. However, Hale knew of Crow as a result of various business contacts. After his dismissal, Crow sold Hale goods, to be delivered by Dixon, and received from Hale a cash deposit for 20% of the purchase price. It was not unusual for an agent in Crow's previous position to receive cash deposits. In an action by Hale against Dixon on the sales contract, Hale will
   a. Lose, because Crow lacked any express or implied authority to make the contract.
   b. Lose, because Crow's conduct constituted a fraud for which Dixon is not liable.
   c. Win, because Dixon's notice was inadequate to terminate Crow's apparent authority.
   d. Win, because a principal is an insurer of an agent's acts.

12. Ivy Corp. engaged Jones as a sales representative and assigned him to a route in southern Florida. Jones worked out of Ivy's main office and his duties, hours, and routes were carefully controlled. The employment contract contained a provision which stated: "I, *Jones,* do hereby promise to hold the corporation harmless from any and all tort liability to third parties which may arise in carrying out my duties as an employee." On a sales call, Jones negligently dropped a case of hammers on the foot of Devlin, the owner of Devlin's Hardware. Which of the following statements is correct?
   a. Ivy has **no** liability to Devlin.
   b. Although the exculpatory clause may be valid between Ivy and Jones, it does **not** affect Devlin's rights.
   c. Ivy is **not** liable to Devlin in any event, since Jones is an independent contractor.
   d. The exculpatory clause is totally invalid since it is against public policy.

13. Wall & Co. hired Carr to work as an agent in its collection department, reporting to the credit manager. Which of the following is correct?
   a. Carr does **not** owe a fiduciary duty to Wall since he does not compete with the company.
   b. Carr will be personally liable for any torts he commits even though they are committed in the course of his employment and pursuant to Wall's directions.
   c. Carr has the implied authority to engage counsel and commence legal action against Wall's debtors.
   d. Carr may commingle funds collected by him if this is convenient as long as he keeps proper records.

14. Steel has been engaged by Lux to act as the agent for Lux, an undisclosed principal. As a result of this relationship
   a. Steel has the same implied powers as an agent engaged by a disclosed principal.
   b. Lux can **not** be held liable for any torts committed by Steel in the course of carrying out the engagement.
   c. Steel will be free from personal liability on authorized contracts for Lux when it is revealed that Steel was acting as an agent.
   d. Lux must file the appropriate form in the proper state office under the fictitious business name statute.

15. Many states require partnerships to file the partnership name under laws which are generally known as fictitious name statutes. These statutes
   a. Require a proper filing as a condition precedent to the valid creation of a partnership.
   b. Are designed primarily to provide registration for tax purposes.
   c. Are designed to clarify the rights and duties of the members of the partnership.
   d. Have little effect on the creation or operation of a partnership other than the imposition of a fine for noncompliance.

16. A general partner of a mercantile partnership
   a. Can by virtue of his acts, impose tort liability upon the other partners.
   b. Has **no** implied authority if the partnership agreement is contained in a formal and detailed signed writing.
   c. Can have his apparent authority effectively negated by express limitations in the partnership agreement.
   d. Can **not** be sued individually for a tort he has committed in carrying on partnership business until the partnership has been sued and a judgment returned unsatisfied.

17. Which of the following is a correct statement concerning a partner's power to bind the partnership?
   a. A partner has **no** authority to bind the partnership after dissolution.
   b. A partner can **not** bind the partnership based upon apparent authority when the other party to the contract knows that the partner lacks actual authority.
   c. A partner has **no** authority in carrying on the regular business of the partnership to convey real property held in the partnership name.
   d. A partner, acting outside the scope of the partner's apparent authority, but with express authority to act, can **not** bind the partnership unless the third party knows of the express authority.

18. Vast Ventures is a limited partnership. The partnership agreement does not contain provisions dealing with the assignment of a partnership interest. The rights of the general and limited partners regarding the assignment of their partnership interests are
   a. Determined according to the common law of partnerships as articulated by the courts.
   b. Basically the same with respect to both types of partners.
   c. Basically the same with the exception that the limited partner must give ten days notice prior to the assignment.
   d. Different in that the assignee of the general partnership interest does not become a substituted partner, whereas the assignee of a limited partnership interest automatically becomes a substituted limited partner.

19. At their annual meeting, shareholders of the Bones Corp. approved several proposals made by the board of directors. Among them was the ratification of the salaries of the executives of the corporation. In this connection, which of the following is correct?
   a. The salaries ratified are automatically valid for federal income tax purposes.
   b. Such ratification by the shareholders is required as a matter of law.
   c. The action by the shareholders serves the purpose of confirming the board's action.
   d. The shareholders can **not** legally ratify the compensation paid to director-officers.

20. King Corp. and Queen Corp. have decided to merge pursuant to the merger provisions of the Model Business Corporation Act, which is the law of their jurisdiction. The statutory merger
   a. Is one type of tax-free reorganization recognized by the Internal Revenue Code.
   b. Is subject to clearly defined rules regarding the percentage and types of securities which may be used to consummate the merger.
   c. May cut off the rights of creditors of the merged corporation.
   d. Requires the approval of the secretary of state or the attorney general at least 90 days prior to consummation of a merger or consolidation.

21. Lamay Associates, a general partnership, and Delray Corporation are contemplating entering into a joint venture. Such a joint venture
   a. Will be treated as an association for federal income tax purposes and taxed at the prevailing corporate rates.
   b. Must incorporate in the state in which the joint venture has its principal place of business.
   c. Will be treated as a partnership in most important legal respects.
   d. Must be dissolved upon completion of a single undertaking.

22. Smith, CPA, contracted to perform certain services for Jones for $500. Jones claimed that the services were not fully performed and therefore disputed the amount of his obligation. As a result, Jones sent Smith a check for only $425 and marked clearly on the check it was "payment in full." Smith crossed out the words "payment in full" and cashed the check. The majority of courts would hold that the debt is
   a. Liquidated and Smith can collect the remaining $75.
   b. Liquidated, but Jones by adding the words "payment in full" cancelled the balance of the debt owed.
   c. Unliquidated and the cashing of the check by Smith completely discharged the debt.
   d. Unliquidated, but the crossing out of the words "payment in full" by Smith revives the balance of $75 owed.

23. Which of the following statements is correct regarding the fiduciary duty?
   a. A majority shareholder as such may owe a fiduciary duty to fellow shareholders.
   b. A director's fiduciary duty to the corporation may be discharged by merely disclosing his self-interest.
   c. A director owes a fiduciary duty to the shareholders but **not** to the corporation.
   d. A promoter of a corporation to be formed owes no fiduciary duty to anyone, unless the contract engaging the promoter so provides.

24. Ambrose purchased 400 shares of $100 par value original issue common stock from Minor Corporation for $25 a share. Ambrose subsequently sold 200 of the shares to Harris at $25 a share. Harris did not have knowledge or notice that Ambrose had not paid par. Ambrose also sold 100 shares of this stock to Gable for $25 a share. At the time of this sale, Gable knew that Ambrose had not paid par for the stock. Minor Corporation became insolvent and the creditors sought to hold all the above parties liable for the $75 unpaid on each of the 400 shares. Under these circumstances
   a. The creditors can hold Ambrose liable for $30,000.
   b. If $25 a share was a fair value for the stock at the time of issuance, Ambrose will have no liability to the creditors.
   c. Since Harris acquired the shares by purchase, he is not liable to the creditors, and his lack of knowledge or notice that Ambrose paid less than par is immaterial.
   d. Since Gable acquired the shares by purchase, he is not liable to the creditors, and the fact that he knew Ambrose paid less than par is immaterial.

25. Decanter Corporation declared a 10% stock dividend on its common stock. The dividend
   a. Must be registered with the SEC pursuant to the Securities Act of 1933.
   b. Requires a vote of the shareholders of Decanter.
   c. Has no effect on the earnings and profits for federal income tax purposes.
   d. Is includable in the gross income of the recipient taxpayers in the year of receipt.

26. In general, which of the following requirements must be satisfied in order to have a valid contract?
   a. A writing.
   b. Consideration.
   c. Mutual promises.
   d. Signatures of all parties.

27. Flaxx, a sales representative of Dome Home Sites, Inc., escorted Mr. & Mrs. Grand through several acres of Dome's proposed subdivision and showed the Grands various one-acre lots for sale at $27,000 each. Upon conclusion of the tour, the Grands expressed interest in purchasing a lot in the near future. Flaxx urged them to show their good faith and sign a letter of intent, which stated: "We, the undersigned, having decided to purchase a lot from Dome Home Sites in the future, deliver to the corporation's agent one hundred dollars ($100) earnest money." This was signed by the Grands at the bottom of the form and the $100 was delivered to Flaxx by the Grands. Under the circumstances
   a. The Grands have made an offer to buy a lot from Dome.
   b. If all the lots are sold by Dome, the Grands have a cause of action for breach of contract.
   c. If no deal is ever consummated, the Grands have the right to the return of the $100.
   d. The $100 constitutes liquidated damages and will be forfeited in the event the Grands do not purchase a lot.

28. Love granted Nelson a written option to buy a tract of land in an industrial park. The option stated that it was irrevocable for 11 days and was given for $20 and other valuable consideration. The $20 was not paid and there was no other valuable consideration. Which of the following is a correct statement regarding the option in question?
   a. Since real property is involved, Nelson's acceptance must be contained in a signed writing if Nelson is to enforce it against Love.
   b. It is an option contract enforceable for the 11-day period.
   c. Acceptance must be received at Love's place of business before expiration of the 11 days.
   d. It is unenforceable because it lacks consideration.

29. West sent a letter to Baker on October 18, 1983, offering to sell a tract of land for $70,000. The offer stated that it would expire on November 1, 1983. Baker sent a letter on October 25, indicating the price was too high and that he would be willing to pay $62,500. On the morning of October 26, upon learning that a comparable property had sold for $72,500, Baker telephoned West and made an unconditional acceptance of the offer at $70,000. West indicated that the price was now $73,000. Baker's letter offering $62,500 arrived the afternoon of October 26. Under the circumstances

   a. West's letter was a firm offer as defined under the Uniform Commercial Code.
   b. Baker validly accepted on the morning of October 26.
   c. There is **no** contract since Baker's acceptance was not in a signed writing.
   d. The parol evidence rule will preclude Baker from contradicting his written statements with oral testimony contra to his letter of October 25.

30. Stone engaged Parker to perform personal services for $1,000 a month for a period of three months. The contract was entered into orally on August 1, 1983, and performance was to commence January 1, 1984. On September 15, Parker anticipatorily repudiated the contract. As a result, Stone can

   a. Obtain specific performance.
   b. Not assign her rights to damages under the contract to a third party.
   c. Immediately sue for breach of contract.
   d. Not enforce the contract against Parker since the contract is oral.

31. Able Corporation was charged with a violation of the Federal Trade Commission Act. Harp, a FTC examiner, concluded that Able had violated the Act and made adverse determinations on several issues. Able believes Harp has been not only arbitrary in several of the determinations, but also clearly incorrect in others. Harp has reached his decision and submitted his opinion. Able has decided not to accept the determinations in the opinion. Assuming Able's allegations are correct, Able

   a. Must accept the determination unless it was denied due process.
   b. Should immediately proceed in the local state court to obtain injunctive relief ordering Harp to reopen the case and redetermine his conclusions.
   c. Should appeal immediately to the local federal district court to overturn the determination.
   d. Must exhaust the available administrative remedies before relief in court can be sought.

32. In general, federal administrative agencies may exercise

   a. Judicial power only.
   b. Executive power only.
   c. Both judicial and executive power, but **not** legislative power.
   d. Executive, judicial, and legislative power.

33. Loop Corp. has made a major breakthrough in the development of a micropencil. Loop has patented the product and is seeking to maximize the profit potential. In this effort, Loop can legally

   a. Require its retailers to sell only Loop's products, including the micropencils, and **not** sell similar competing products.
   b. Require its retailers to take stipulated quantities of its other products in addition to the micropencils.
   c. Sell the product at whatever price the traffic will bear even though Loop has a monopoly.
   d. Sell the product to its retailers upon condition that they do **not** sell the micropencils to the public for less than a stated price.

34. Certain members of the Tri-State Railway Construction Association decided that something must be done about the disastrous competition, which, when coupled with the depressed status of the industry and economy, was causing financial chaos for many of its members. They met privately after one of the association meetings and decided to allocate construction projects among themselves based upon an historical share of the market. Under the arrangement, a certain designated company would submit the low bid, thereby ensuring that the company would obtain the job. Such an arrangement is

   a. Illegal per se, and a criminal violation of the antitrust law.
   b. Illegal under the rule of reason, but **not** a criminal violation of the antitrust law.
   c. Legally justifiable due to the economic conditions in the marketplace.
   d. Legal under antitrust law since it does **not** fix prices.

35. In a pure conglomerate merger

   a. The government must establish an actual restraint on competition in the marketplace in order to prevent the merger.
   b. The acquiring corporation **neither** competes with **nor** sells to or buys from the acquired corporation.
   c. The merger is prima facie valid unless the government can prove the acquiring corporation had an intent to monopolize.
   d. Some form of additional anticompetitive behavior must be established (e.g., price fixing) in order to provide the basis for the government's obtaining of injunctive relief.

36. In contesting the validity of a previously consummated vertical merger
   a. The Justice Department must proceed within five years of the consummation of the merger.
   b. The fact that the acquiring corporation deliberately failed to apply for a ruling is presumptive evidence of bad faith.
   c. The Justice Department must show the likelihood that competition may be foreclosed in a substantial share of that market.
   d. Only a showing of actual substantial lessening of competition will be sufficient to establish illegality.

37. If a defendant is charged with an unfair method of competition under the Federal Trade Commission Act
   a. The FTC may prevail despite the fact that the conduct alleged to be illegal did **not** violate either the Sherman or Clayton Act.
   b. Criminal sanctions can generally be imposed against a defendant even though the defendant has **not** violated an FTC order to cease and desist.
   c. There can be **no** violation of the Act unless one or more of the specifically enumerated unfair methods of competition are established.
   d. The complaint must be based upon the purchase or sale of goods, wares, or commodities in interstate commerce.

38. The Justice Department is proceeding criminally against RSV Corp. and Knox, its president and chief operating officer, for conspiring to fix prices in the greeting card industry. If found guilty
   a. RSV could be fined a maximum of $500,000.
   b. Knox could be fined a maximum of $50,000 or be given a prison term, but not both.
   c. Knox would be guilty of a felony and could be sentenced to a prison term not exceeding three years.
   d. RSV may deduct the amount of any fine imposed against it on its federal income tax return.

39. Hicks is employed as executive sales manager by Foster Fabrics. She received a salary of $30,000 in 1982. In addition, she earned $15,000 net in 1982 as a free lance photographer. As a result of the above earnings for 1982 and the application of the provisions of the Federal Insurance Contributions Act, Hicks
   a. Owed nothing since her salary was fully subjected to withholding of FICA tax by Foster.
   b. Was required to pay a self-employment tax on the difference between the FICA tax base amount and $30,000.
   c. Was required to pay both an employer and employee FICA tax on the $15,000.
   d. Was required to ascertain the gross amount of income from the free lance photography and compute the FICA tax owed on that amount.

40. The Equal Employment Opportunity Commission
   a. Has authority to impose criminal penalties under the Equal Employment Opportunity Act.
   b. Has the power to file a civil suit in federal district court and to represent a person charging a violation of the act.
   c. Has **no** jurisdiction over the Civil Rights Act.
   d. Has authority to issue cease and desist orders in those cases where there have been repeated violations.

41. There are federal and state unemployment taxes. Regarding the Federal Unemployment Tax Act
   a. Payment of the tax is shared equally by the employer and the employee.
   b. Employees who earn less than $7,000 are exempt from coverage.
   c. Benefits to an employee can **not** exceed the amount contributed to his account.
   d. A credit is generally available for contributions made by the employer to state unemployment funds.

42. The Securities Exchange Act of 1934 holds certain insiders liable for short-swing profits under section 16(b) of the Act. Which of the following individuals would **not** be an insider in relation to the corporation in which he or she owns securities?
   a. A major debenture holder.
   b. An executive vice president.
   c. A director who owns less than 10% of the shares of stock of the corporation.
   d. A 13% owner, 9% of which is held in the owner's name and 4% in an irrevocable trust for his or her benefit for life.

43. Although the Securities and Exchange Commission has broad powers in conducting a formal investigative proceeding, the SEC can **not**
   a. Impose monetary penalties without court proceedings.
   b. Compel a witness to appear.
   c. Subpoena records.
   d. Conduct its investigations secretly.

44. The president of XK Corporation has been charged by the Securities and Exchange Commission with a criminal violation of the Securities Exchange Act of 1934. Under these circumstances
   a. The SEC may elect to prosecute the case itself or turn the case over to the Justice Department.
   b. It is irrelevant whether the president had knowledge of his wrongdoing in determining whether to impose a fine or prison term.
   c. The SEC must elect between civil and criminal action but may **not** pursue both.
   d. A fine or prison term or both may be imposed.

45. Which of the following corporations are subject to the accounting requirements of the Foreign Corrupt Practices Act?
   a. All corporations engaged in interstate commerce.
   b. All domestic corporations engaged in international trade.
   c. All corporations which have made a public offering under the Securities Act of 1933.
   d. All corporations whose securities are registered pursuant to the Securities Exchange Act of 1934.

46. Hack Company owned 100 tires which it deposited in a public warehouse on April 25, receiving a negotiable warehouse receipt in its name. Hack sold the tires to Fast Freight Co. On which of the following dates did the risk of loss transfer from Hack to Fast?
   a. May 1 — Fast signed a contract to buy the tires from Hack for $15,000. Delivery was to be at the warehouse.
   b. May 2 — Fast paid for the tires.
   c. May 3 — Hack negotiated the warehouse receipt to Fast.
   d. May 4 — Fast received delivery of the tires at the warehouse.

47. Thieves broke into the warehouse of Monogram Airways and stole a shipment of computer parts belonging to Valley Instruments. Valley had in its possession a negotiable bill of lading covering the shipment. The thieves transported the stolen parts to another state and placed the parts in a bonded warehouse. The thieves received a negotiable warehouse receipt which they used to secure a loan of $20,000 from Reliable Finance. These facts were revealed upon apprehension of the thieves. Regarding the rights of the parties
   a. Reliable is entitled to a $20,000 payment before relinquishment of the parts.
   b. Monogram will be the ultimate loser of the $20,000.
   c. Valley is entitled to recover the parts free of Reliable's $20,000 claim.
   d. Valley is **not** entitled to the parts but may obtain damages from Monogram.

48. In order to qualify as an investment security under the Uniform Commercial Code, an instrument must be
   a. Issued in registered form, and **not** bearer form.
   b. Of a long-term nature not intended to be disposed of within one year.
   c. Only an equity security or debenture security, and **not** a secured obligation.
   d. In a form that evidences a share, participation or other interest in property or in an enterprise, or evidences an obligation of the issuer.

49. Weber had a negotiable instrument in his possession which he had received in payment of certain equipment he had sold to Roth Merchandising. The instrument was originally payable to the order of Martin Burns or bearer. It was endorsed specially by Burns to Roth who in turn negotiated it to Weber via a blank endorsement. The instrument in question, along with some cash and other negotiable instruments, was stolen from Weber on October 1, 1983. Which of the following is correct?
   a. The theft constitutes a common law conversion which prevents anyone from obtaining a better title to the instrument than the owner.
   b. A holder in due course will prevail against Weber's claim to the instrument.
   c. Once an instrument is bearer paper it is always bearer paper.
   d. Weber's signature was necessary in order to further negotiate the instrument.

50. Which of the following requirements must be met for modification of a sales contract under the Uniform Commercial Code?
   a. The modification must satisfy the Statute of Frauds if the contract as modified is within its provisions.
   b. There must be consideration present if the contract is between merchants.
   c. The parol evidence rule applies and thus a writing is required.
   d. There must be a writing if the original sales contract is in writing.

51. In order to have an irrevocable offer under the Uniform Commercial Code, the offer must
   a. Be made by a merchant to a merchant.
   b. Be contained in a signed writing which gives assurance that the offer will be held open.
   c. State the period of time for which it is irrevocable.
   d. Not be contained in a form supplied by the offeror.

52. Gold sold Sable ten fur coats. The contract contained no specific provision regarding title warranties. It did, however, contain a provision which indicated that the coats were sold "with all faults and defects." Two of the coats sold to Sable had been stolen and were reclaimed by the rightful owner. Which of the following is a correct statement?
   a. The implied warranty of title is eliminated by the parol evidence rule.
   b. The contract automatically contained a warranty that the title conveyed is good and can only be excluded by specific language.
   c. Since there was **no** express title warranty, Sable assumed the risk.
   d. The disclaimer "with all faults and defects" effectively negates any and all warranties.

53. On October 1, Baker, a wholesaler, sent Clark, a retailer, a written signed offer to sell 200 pinking shears at $9 each. The terms were F.O.B. Baker's warehouse, net 30, late payment subject to a 15% per annum interest charge. The offer indicated that it must be accepted no later than October 10, that acceptance would be effective upon receipt, and that the terms were not to be varied by the offeree. Clark sent a telegram which arrived on October 6, and accepted the offer expressly subject to a change of the payment terms to 2/10, net/30. Baker phoned Clark on October 7, rejecting the change of payment terms. Clark then indicated it would accept the October 1 offer in all respects, and expected delivery within 10 days. Baker did not accept Clark's oral acceptance of the original offer. Which of the following is a correct statement?

a. Baker's original offer is a firm offer, hence irrevocable.
b. There is **no** contract since Clark's modifications effectively rejected the October 1 offer, and Baker never accepted either of Clark's proposals.
c. Clark actually created a contract on October 6, since the modifications were merely proposals and did **not** preclude acceptance.
d. The statute of frauds would preclude the formation of a contract in any event.

54. The Uniform Commercial Code implies a warranty of merchantability to protect buyers of goods. To be subject to this warranty the goods need **not** be

a. Fit for all of the purposes for which the buyer intends to use the goods.
b. Adequately packaged and labeled.
c. Sold by a merchant.
d. In conformity with any promises or affirmations of fact made on the container or label.

55. Donaldson suffered an injury due to a malfunction of a power tool he had purchased from Malloy Hardware. The tool was manufactured by Superior Tool Company. Donaldson has commenced an action against Malloy and Superior based upon strict liability. Which of the following is a correct statement?

a. Donaldson's suit against Malloy will be dismissed since Malloy was **not** at fault.
b. Privity will **not** be a valid defense against Donaldson's suit.
c. Superior will **not** be liable if it manufactured the tool in a nonnegligent manner.
d. The lawsuit will be dismissed since strict liability has **not** been applied in product liability cases in the majority of jurisdictions.

56. In deciding a controversy involving the question of who has the risk of loss, the court will look primarily to

a. The intent of the parties manifested in the contract.
b. The shipping terms used by the parties.
c. Whether title has passed.
d. The insurance coverage of the parties.

57. Dey ordered 100 cases of Fancy Brand carrots at list price from Ned Wholesaler. Immediately upon receipt of Dey's order, Ned sent Dey an acceptance which was received by Dey. The acceptance indicated that shipment would be made within seven days. On the seventh day Ned discovered that all of its supply of Fancy Brand carrots had been sold. Instead it shipped 100 cases of Rabbit Brand, stating clearly on the invoice that the shipment was sent only as an accommodation. Which of the following is correct?

a. Ned's note of accommodation cancels the contract between Ned and Dey.
b. Dey's order is a unilateral offer, and can only be accepted by Ned's shipment of the goods ordered.
c. Ned's shipment of Rabbit Brand constitutes **a** breach of contract.
d. Ned's shipment of Rabbit Brand is a counteroffer, thus **no** contract exists between Dey and Ned.

58. Marvin contracted to purchase goods from Ling. Subsequently, Marvin breached the contract and Ling is seeking to recover the contract price. Ling can recover the price if

a. Ling does **not** seek to recover any damages in addition to the price.
b. The goods have been destroyed and Ling's insurance coverage is inadequate, regardless of risk of loss.
c. Ling has identified the goods to the contract and the circumstances indicate that a reasonable effort to resell the goods at a reasonable price would be to no avail.
d. Marvin anticipatorily repudiated the contract and specific performance is **not** available.

59. Dodd Company sold Barney & Company 10,000 ball point pens. The shipment, upon inspection, was found to be nonconforming and Barney rejected the pens. Barney purchased the pens elsewhere at a price which was $525 more than the contract price. The Dodd sales contract contained a clause which purported to reduce the statute of limitations provision of the Uniform Commercial Code to one year. Barney has done nothing about the breach except to return the pens and demand payment of the $525 damages. Dodd has totally ignored Barney's claim. The statute of limitations

a. Is four years according to the Uniform Commercial Code and can **not** be reduced by the original agreement.
b. Will totally bar recovery unless suit is commenced within the time specified in the contract.
c. May be extended by the parties but **not** beyond five years.
d. Can **not** be reduced by the parties to a period less than two years.

60. Hall is suing the manufacturer, the wholesaler, and the retailer for bodily injuries caused by a lawnmower Hall purchased. Under the theory of strict liability
   a. Privity will be a bar insofar as the wholesaler is concerned if the wholesaler did **not** have a reasonable opportunity to inspect.
   b. Contributory negligence on Hall's part will always be a bar to recovery.
   c. The manufacturer will avoid liability if it can show it followed the custom of the industry.
   d. Hall may recover despite the fact that he can **not** show that any negligence was involved.

Number 2 (Estimated time —— 15 to 20 minutes)

Part a. Despard Finance Company is a diverse, full-line lending institution. Its "Problems & Potential Litigation" file revealed the following disputes involving loans extended during the year of examination.

- Despard loaned Fish $4,500 to purchase a $5,000 video recording system for his personal use. A note, security agreement, and financing statement, which was promptly filed, were all executed by Fish. Unknown to Despard, Fish had already purchased the system from Zeals Department Stores the previous day for $5,000. The terms were 10% down, the balance monthly, payable in three years, and a written security interest granted to Zeals. Zeals did not file a financing statement until default.

- Despard loaned Moderne Furniture Co. $13,000 to purchase certain woodworking equipment. Moderne did so. A note, security agreement, and financing statement were executed by Moderne. As a result of an oversight the financing statement was not filed until 30 days after the loan-purchase by Moderne. In the interim Moderne borrowed $11,000 from Apache National Bank using the newly purchased machinery as collateral for the loan. A financing statement was filed by Apache five days prior to Despard's filing.

Required: Answer the following, setting forth reasons for any conclusions stated.

What are the priorities among the conflicting security interests in the same collateral claimed by Despard and the other lenders?

Part b. Hardy & Company was encountering financial difficulties. Melba, a persistent creditor whose account was overdue, demanded a check for the amount owed to him. Hardy's president said that this was impossible since the checking account was already overdrawn. However, he indicated he would be willing to draw on funds owed by one of the company's customers. He drafted and presented to Melba the following instrument.

October 1, 1983

TO:
Stitch Fabrications, Inc.
2272 University Avenue
Pueblo, Colorado 81001

Pay Hardy & Company, ONE THOUSAND and no/100 dollars ($1,000.00) 30 days after acceptance, for value received in connection with our shipment of August 11, 1983.

Hardy & Company
by Charles Hardy, President
242 Oak Lane Drive
Hinsdale, Illinois 60521

Accepted by: ____________________

Hardy endorsed the instrument on the back as follows:

Pay to the order of Walter Melba

Hardy & Company
Charles Hardy, President

Melba asserts that he is a holder in due course.

Required: Answer the following, setting forth reasons for any conclusions stated.

1. What type of instrument is the above? How and in what circumstances is it used?
2. Is it negotiable?
3. Assume that the instrument is negotiable and accepted by Stitch, but prior to payment, Stitch discovers the goods are defective. May Stitch successfully assert this defense against Melba to avoid payment of the instrument?

Number 3 (Estimated time —— 15 to 20 minutes)

Part a. Skidmore, doing business as Frock & Fashions, is hopelessly insolvent. Several of his aggressive creditors are threatening to attach his property or force him to make preferential payments of their debts. In fairness to himself and to all his creditors, Skidmore has filed a voluntary petition in bankruptcy on behalf of himself and Frock & Fashions. An order for relief has been entered.

Skidmore's bankruptcy is fairly straightforward with the following exceptions:

- Skidmore claims exemptions for his summer cottage and for his home.
- Morse, a business creditor, asserts that commercial creditors have a first claim to all Skidmore's property, business and personal.
- Walton seeks a denial of Skidmore's discharge since Skidmore obtained credit from him by use of a fraudulent financial statement.
- Harper claims a priority for the amount owed him which was not satisfied as a result of his resorting to the collateral securing his loan.

Required: Answer the following, setting forth reasons for any conclusions stated.

1. What are the principal avoiding powers of the trustee in bankruptcy?
2. Discuss in separate paragraphs each of the various claims and assertions stated above.

Part b. Mars Finance Company was approached by Grant, the president of Hoover Corp., for a loan of $25,000 for Hoover. After careful evaluation of Hoover's financial condition, Mars decided it would not make the loan unless the loan was collateralized or guaranteed by one or more sureties for a total of $30,000. Hoover agreed to provide collateral in the form of a security interest in Hoover's equipment. The initial valuation of the equipment was $20,000 and Hoover obtained Victory Surety Company as a surety for the additional $10,000. Prior to the granting of the loan, the final valuation on the equipment was set at $15,000 and Mars insisted on additional surety protection of $5,000. Grant personally assumed this additional surety obligation. Hoover has defaulted and Mars first proceeded against the collateral, which was sold for $17,000. It then proceeded against Victory for the balance. Victory paid the $8,000 and now seeks a $4,000 contribution from Grant.

Grant asserts the following defenses and arguments in order to avoid or limit his liability:

- That he is not liable since Mars elected to proceed against the collateral.
- That Mars by suing Victory for the deficiency, released him.
- That he is not a cosurety because Victory did not know of his existence until after default and his surety obligation was not assumed at the same time nor was it equal in amount, hence, there is no right of contribution.
- That in no event is he liable for the full $4,000 sought by Victory.

Required: Answer the following, setting forth reasons for any conclusions stated.

Discuss in separate paragraphs each of the above defenses asserted by Grant and indicate the amount of Grant's liability.

Number 4 (Estimated time —— 15 to 20 minutes)

Bar Manufacturing and Cole Enterprises were arch rivals in the high technology industry and both were feverishly working on a new product which would give the first to develop it a significant competitive advantage. Bar engaged Abel Consultants on April 1, 1983, for one year, commencing immediately, at $7,500 a month to aid the company in the development of the new product. The contract was oral and was consummated by a handshake. Cole approached Abel and offered them a $10,000 bonus for signing, $10,000 a month for nine months, and a $40,000 bonus if Cole was the first to successfully market the new product. In this connection, Cole stated that the oral contract Abel made with Bar was unenforceable and that Abel could walk away from it without liability. In addition, Cole made certain misrepresentations regarding the dollar amount of its commitment to the project, the stage of its development, and the expertise of its research staff. Abel accepted the offer.

Four months later, Bar successfully introduced the new product. Cole immediately dismissed Abel and has paid nothing beyond the first four $10,000 payments plus the initial bonus. Three lawsuits ensued: Bar sued Cole, Bar sued Abel, and Abel sued Cole.

Required: Answer the following, setting forth reasons for any conclusions stated.

Discuss the various theories on which each of the three lawsuits is based, the defenses which will be asserted, the measure of possible recovery, and the probable outcome of the litigation.

Number 5 (Estimated time —— 15 to 20 minutes)

Part a. Dogwood Construction Company purchased from Acorn a tract of land for use in its business. There was a secondary roadway in the rear of the tract. At the closing of the sale, Dogwood received a deed with a description which was based on a 20-year old survey. The survey showed the secondary road to be entirely included within the tract purchased. The survey was in error by approximately nine feet and therefore did not reveal that the roadway was encroaching upon an adjoining tract of land by six feet. Acorn was the only prior owner of the property, which included both tracts of land. He had owned both tracts for 11 years, and had continuously used the back road. Dogwood took possession and used the back road for five years until Maple purchased the adjoining tract. Maple's survey accurately indicated the exact location of the boundary lines in relation to the road. Consequently, Maple informed Dogwood that unless it ceased using the road, that he, Maple, would bring an action for trespass. Dogwood claims an easement right to continue to use the road.

Required: Answer the following, setting forth reasons for any conclusions stated.

1. What kind of an easement is Dogwood claiming?

2. In general, what are the requirements that must be satisfied by Dogwood to establish such an easement?

3. In the event Maple brought a lawsuit for trespass against Dogwood, who would likely prevail?

Part b. Mr. & Mrs. Charles Crawford were in the 50% income tax bracket for federal income tax purposes. The Crawfords had two children, June and Virgil, ages 16 and 15. The Crawfords decided that they would like to shift some of their income to the children, but were unwilling to make outright gifts. They consulted with their CPA, banker and attorney and, after considerable discussion, decided to create a short-term irrevocable trust for the benefit of the children with Clearview Trust Company as trustee. The duration of the trust was, as stated in the trust agreement, ten years plus one day from the execution of the trust agreement. The trust agreement was dated August 1, 1982, and the intent of the parties was to convey the Sunnydale property to the trustee after the mortgage on the property had been satisfied. The mortgage was satisfied on November 15, 1982, and the property conveyed in trust to the trustee on December 1, 1982. Net rental income from the Sunnydale property for the period from December 1, 1982 to December 31, 1982, the end of the tax year chosen for the trust, was $14,000. This amount was paid to the children in 1982 and $7,000 of trust income was reported for income tax purposes by each of the children. Mr. & Mrs. Crawford excluded the $14,000 from their income tax return.

As a result of a routine audit of the Crawford family returns for 1982, the Internal Revenue Service refused to accept the income as being properly includable in the children's returns and reallocated it to Mr. & Mrs. Crawford.

Required: Answer the following, setting forth reasons for any conclusions stated.

1. What are the basic elements for the creation of a valid trust?

2. At what point in time was the trust created in this case?

3. Is the Internal Revenue Service's denial of the shifting of the $14,000 income to the children proper?

4. Can Mr. & Mrs. Crawford, without the consent of the beneficiaries revoke the trust, assuming the Internal Revenue Service is correct?

(Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, territories, and the District of Columbia.)

EXAMINATION IN ACCOUNTING THEORY

(Theory of Accounts)

November 4, 1983; 1:30 to 5:00 P.M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Estimated Minutes* *Maximum*
No. 1	90	110
No. 2	15	25
No. 3	15	25
No. 4	15	25
No. 5	15	25
Total	150	210

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, they should be numbered 1 through 12. The printed answer sheet provided for the objective-type items should be considered to be Page 1.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers.

3. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Number 1 (Estimated time —— 90 to 110 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of issues in accounting.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

99. The financial statement which summarizes the financial position of a company is the
    a. Income statement.
    b. Balance sheet.
    c. Statement of changes in financial position.
    d. Retained earnings statement.

Answer Sheet

99. (a) ● (c) (d)

Items to be Answered

1. Under Statement of Financial Accounting Concepts No. 3, comprehensive income includes which of the following?

	Losses	*Contribution margin*
a.	No	No
b.	No	Yes
c.	Yes	Yes
d.	Yes	No

2. Under Statement of Financial Accounting Concepts No. 3, the term recognized is synonymous with the term
    a. Recorded.
    b. Realized.
    c. Matched.
    d. Allocated.

3. Some costs cannot be directly related to particular revenues but are incurred to obtain benefits in the period in which the costs are incurred. An example of such a cost is
    a. Electricity used to light offices.
    b. Transportation to customers.
    c. Cost of merchandise sold.
    d. Sales commissions.

4. When computing information on a historical cost/constant dollar basis, which of the following is classified as monetary?
    a. Equity investment in unconsolidated subsidiaries.
    b. Obligations under warranties.
    c. Unamortized discount on bonds payable.
    d. Deferred investment tax credits.

5. A security in a current marketable equity securities portfolio is transferred to a noncurrent marketable equity securities portfolio. The security should be transferred between the corresponding portfolios at
    a. The book value at date of transfer if higher than the market value at date of transfer.
    b. The market value at date of transfer, regardless of its cost.
    c. Its cost, regardless of the market value at date of transfer.
    d. The lower of its cost or market value at date of transfer.

6. Cash dividends declared out of current earnings are distributed to an investor. How will the investor's investment account be affected by those dividends under each of the following accounting methods?

	Cost method	*Equity method*
a.	Decrease	No effect
b.	Decrease	Decrease
c.	No effect	Decrease
d.	No effect	No effect

7. After being held for 30 days, a 90-day 15% interest-bearing note receivable was discounted at a bank at 18%. The proceeds received from the bank upon discounting would be the
    a. Maturity value less the discount at 18%.
    b. Maturity value plus the discount at 18%.
    c. Face value less the discount at 18%.
    d. Face value plus the discount at 18%.

8. On July 1, 1983, a company received a one-year note receivable bearing interest at the market rate. The face amount of the note receivable and the entire amount of the interest are due on June 30, 1984. When the note receivable was recorded on July 1, 1983, which of the following were debited?

	Interest receivable	*Unearned discount on note receivable*
a.	Yes	No
b.	Yes	Yes
c.	No	No
d.	No	Yes

9. From a theoretical viewpoint, which of the following costs would be considered inventoriable?

	Freight	*Warehousing*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

10. The dollar value LIFO inventory cost flow method uses which of the following?
  a. Specific goods (single item) pools.
  b. Specific cost identification method.
  c. Double-extension method.
  d. Moving average method.

11. The replacement cost of an inventory item is below the net realizable value and above the net realizable value less the normal profit margin. The original cost of the inventory item is above the replacement cost and below the net realizable value. As a result, under the lower of cost or market method, the inventory item should be valued at the
  a. Replacement cost.
  b. Original cost.
  c. Net realizable value.
  d. Net realizable value less the normal profit margin.

12. A purchased patent has a remaining legal life of 15 years. It should be
  a. Expensed in the year of acquisition.
  b. Amortized over 15 years regardless of its useful life.
  c. Amortized over its useful life if less than 15 years.
  d. Amortized over 40 years.

13. The issuer of a 10-year term bond sold at par three years ago with interest payable May 1 and November 1 each year, should report on its December 31 balance sheet a (an)
  a. Liability for accrued interest.
  b. Addition to bonds payable.
  c. Increase in deferred charges.
  d. Contingent liability.

14. The market rate of interest for a bond issue which sells for more than its par value is
  a. Independent of rate stated on the bond.
  b. Higher than rate stated on the bond.
  c. Equal to rate stated on the bond.
  d. Less than rate stated on the bond.

15. How would the amortization of premium on bonds payable affect each of the following?

	Carrying value of bond	*Net income*
a.	Increase	Decrease
b.	Increase	Increase
c.	Decrease	Decrease
d.	Decrease	Increase

16. A gain on the conversion of outstanding bonds into common stock would be recognized when using the

	Book value method	*Market value method*
a.	Yes	No
b.	Yes	Yes
c.	No	No
d.	No	Yes

17. Which of the following material gains on refunding of bonds payable should be recognized separately as an extraordinary gain?

	Direct exchange of old bonds for new bonds	*Issuance of new bonds; proceeds used to retire old bonds*
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

18. On December 20, 1982, an uninsured property damage loss was caused by a company car being driven on company business by a company salesman. The company did not become aware of the loss until January 25, 1983. The amount of the loss was reasonably estimable before the company's 1982 financial statements were issued. The company's December 31, 1982, financial statements should report an estimated loss as
  a. A disclosure, but **not** an accrual.
  b. An accrual.
  c. Neither an accrual nor a disclosure.
  d. An appropriation of retained earnings.

19. The excess of the subscription price over the par value should be recorded as additional paid-in capital for

	Common stock	*Preferred stock*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

20. A property dividend should be debited to retained earnings at the property's
  a. Market value at date of declaration.
  b. Market value at date of issuance (payment).
  c. Book value at date of declaration.
  d. Book value at date of issuance (payment).

21. The issuer should charge retained earnings for the market value of the shares issued in a (an)
   a. 10 percent stock dividend.
   b. 2 for 1 stock split.
   c. Employee stock bonus.
   d. Pooling of interests.

22. When treasury stock is purchased for cash at more than its par value, what is the effect on total stockholders' equity under each of the following methods?

	Cost method	*Par value method*
a.	Increase	Increase
b.	Decrease	Decrease
c.	No effect	Decrease
d.	No effect	No effect

23. A company issued rights to its existing shareholders to purchase, for $30 per share, 10,000 unissued shares of $15 par value common stock. When the rights are exercised
   a. Additional paid-in capital will be debited.
   b. Additional paid-in capital will be credited.
   c. Stock rights outstanding will be debited.
   d. Retained earnings will be debited.

24. When an investor uses the equity method to account for investments in common stock, the equity in the earnings of the investee reported in the investor's income statement will be affected by which of the following?

	Cash dividends from investee	*Goodwill amortization related to purchase*
a.	No	Yes
b.	No	No
c.	Yes	No
d.	Yes	Yes

25. A sale of goods, denominated in a currency other than the entity's functional currency, resulted in a receivable that was fixed in terms of the amount of foreign currency that would be received. Exchange rates between the functional currency and the currency in which the transaction was denominated changed. The resulting gain should be included as a (an)
   a. Separate component of stockholders' equity.
   b. Deferred credit.
   c. Component of income from continuing operations.
   d. Extraordinary item.

26. In determining whether to accrue employees' compensation for future absences, one of the conditions that must be met is that the employer has an obligation to make payment even if an employee terminates. This is an example of a (an)
   a. Vested right.
   b. Accumulated right.
   c. Contingent right.
   d. Estimable right.

27. In the calculation of the annual provision for pension cost, 10 percent of past service cost (until fully amortized) would be included in the

	Minimum limit	*Maximum limit*
a.	Yes	Yes
b.	Yes	No
c.	No	No
d.	No	Yes

28. When a segment of a business has been discontinued during the year, the loss on disposal should
   a. Be an extraordinary item.
   b. Be an operating item.
   c. Exclude operating losses of the current period up to the measurement date.
   d. Exclude operating losses during the phase-out period.

29. A loss from early extinguishment of debt, if material, should be reported as a component of income
   a. After cumulative effect of accounting changes and after discontinued operations of a segment of a business.
   b. After cumulative effect of accounting changes and before discontinued operations of a segment of a business.
   c. Before cumulative effect of accounting changes and after discontinued operations of a segment of a business.
   d. Before cumulative effect of accounting changes and before discontinued operations of a segment of a business.

30. The conversion of nonparticipating preferred stock into common stock should be presented in a statement of changes in financial position as a

	Source of funds	*Use of funds*
a.	Yes	Yes
b.	Yes	No
c.	No	No
d.	No	Yes

31. In a statement of changes in financial position, the amortization of goodwill of a company with substantial operating profits should be presented as a (an)
   a. Source and use of funds.
   b. Use of funds.
   c. Deduction from income from continuing operations.
   d. Addition to income from continuing operations.

32. A company has included in its consolidated financial statements this year a subsidiary acquired several years ago that was appropriately excluded from consolidation last year. This results in
   a. An accounting change that should be reported prospectively.
   b. An accounting change that should be reported by restating the financial statements of all prior periods presented.
   c. A correction of an error.
   d. Neither an accounting change nor a correction of an error.

33. On November 1, 1982, Company X acquired all of the outstanding common stock of Company Y in a business combination accounted for as a pooling of interests. Both companies have a December 31 year end and have been in business for many years. Consolidated net income for the year ended December 31, 1982, should include net income for 12 months of

	Company X	*Company Y*
a.	Yes	Yes
b.	Yes	No
c.	No	No
d.	No	Yes

34. In order to report a business combination as a pooling of interests, the minimum amount of an investee's common stock which must be acquired during the combination period in exchange for the investor's common stock is
   a. 100 percent.
   b. 51 percent.
   c. 80 percent.
   d. 90 percent.

35. For external reporting purposes, it is appropriate to use estimated gross profit rates to determine the cost of goods sold for

	Interim financial reporting	*Year-end financial reporting*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

36. Wages paid to factory machine operators of a manufacturing plant are an element of

	Prime cost	*Conversion cost*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

37. Property taxes on a manufacturing plant are an element of

	Conversion cost	*Period cost*
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

38. Factory supplies for a manufacturing plant are generally
   a. Prime costs.
   b. Period costs.
   c. Variable costs.
   d. Excluded from product costs.

39. Accounting for factory overhead costs involves averaging in

	Job order costing	*Process costing*
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

40. Assuming that there was no beginning work in process inventory, and the ending work in process inventory is 50% complete as to conversion costs, the number of equivalent units as to conversion costs would be
   a. The same as the units placed in process.
   b. The same as the units completed.
   c. Less than the units placed in process.
   d. Less than the units completed.

41. In the computation of manufacturing cost per equivalent unit, the weighted-average method of process costing considers
   a. Current costs only.
   b. Current costs plus cost of ending work in process inventory.
   c. Current costs less cost of beginning work in process inventory.
   d. Current costs plus cost of beginning work in process inventory.

42. Under the two-variance method for analyzing factory overhead, the volume variance is the difference between the
   a. Budget allowance based on standard hours allowed and the budget allowance based on actual hours worked.
   b. Budget allowance based on standard hours allowed and the factory overhead applied to production.
   c. Actual factory overhead and the budget allowance based on standard hours allowed.
   d. Actual factory overhead and the factory overhead applied to production.

43. Under the three-variance method for analyzing factory overhead, which of the following is used in the computation of the spending variance?

	Actual factory overhead	*Factory overhead applied to production*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

44. The direct (variable) costing method includes in inventory
  a. Direct materials cost, direct labor cost, but **no** factory overhead cost.
  b. Direct materials cost, direct labor cost, and variable factory overhead cost.
  c. Prime cost but **not** conversion cost.
  d. Prime cost and all conversion cost.

45. How would the following be used in calculating sales necessary to realize a projected profit?

	Projected profit	*Contribution margin ratio*
a.	Denominator	Numerator
b.	Denominator	Not used
c.	Numerator	Numerator
d.	Numerator	Denominator

46. The contribution margin decreases when sales volume remains the same and
  a. Fixed costs increase.
  b. Fixed costs decrease.
  c. Variable cost per unit increases.
  d. Variable cost per unit decreases.

47. The discount rate (hurdle rate of return) must be determined in advance for the
  a. Payback period method.
  b. Time adjusted rate of return method.
  c. Internal rate of return method.
  d. Net present value method.

48. Which of the following capital budgeting techniques consider(s) cash flow over the entire life of the project?

	Internal rate of return	*Payback*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

49. A company's return on investment (ROI) would generally increase when
  a. Assets increase.
  b. Selling prices decrease.
  c. Costs decrease.
  d. Costs increase.

50. Simple regression analysis
  a. Establishes a cause and effect relationship.
  b. Produces measures of probable error.
  c. Involves the use of independent variables only.
  d. Involves the use of more than two variables.

51. Which of the following accounts of a governmental unit is credited when the budget is recorded?
  a. Encumbrances.
  b. Reserve for encumbrances.
  c. Estimated revenues.
  d. Appropriations.

52. Which of the following accounts of a governmental unit is debited when supplies previously ordered are received?
  a. Encumbrances.
  b. Reserve for encumbrances.
  c. Vouchers payable.
  d. Appropriations.

53. When fixed assets purchased from general fund revenues were received, the appropriate journal entry was made in the general fixed asset account group. What account, if any, should have been debited in the general fund?
  a. No journal entry should have been made in the general fund.
  b. Fixed assets.
  c. Expenditures.
  d. Due from general fixed asset account group.

54. Which of the following funds of a governmental unit integrates budgetary accounts into the accounting system?
  a. Enterprise.
  b. Special revenue.
  c. Internal service.
  d. Nonexpendable trust.

55. Which of the following funds of a governmental unit uses the modified accrual basis of accounting?
  a. Debt service.
  b. Internal service.
  c. Enterprise.
  d. Nonexpendable trust.

56. Long-term liabilities of an enterprise fund should be accounted for in the

	Enterprise fund	*Long-term debt account group*
a.	No	No
b.	No	Yes
c.	Yes	Yes
d.	Yes	No

57. Fixed assets should be accounted for in the general fixed assets account group for

	Governmental funds	*Proprietary funds*
a.	No	Yes
b.	No	No
c.	Yes	No
d.	Yes	Yes

58. The comprehensive annual financial report (CAFR) of a governmental unit should contain a combined statement of changes in financial position for

	Governmental funds	*Proprietary funds*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

59. The current funds group of a not-for-profit private university includes which of the following subgroups?

	Term endowment funds	*Life income funds*
a.	No	No
b.	No	Yes
c.	Yes	Yes
d.	Yes	No

60. Which of the following would normally be included in Other Operating Revenues of a voluntary not-for-profit hospital?

a. Unrestricted interest income from an endowment fund.
b. An unrestricted gift.
c. Donated services.
d. Tuition received from an educational program.

Number 2 (Estimated time —— 15 to 25 minutes)

George Company purchased land for use as its corporate headquarters. A small factory that was on the land when it was purchased was torn down before construction of the office building began. Furthermore, a substantial amount of rock blasting and removal had to be done to the site before construction of the building foundation began. Because the office building was set back on the land far from the public road, George Company had the contractor construct a paved road which led from the public road to the parking lot of the office building.

Three years after the office building was occupied, George Company added four stories to the office building. The four stories had an estimated useful life of five years more than the remaining estimated useful life of the original office building.

Ten years later the land and building were sold at an amount more than their net book value and George Company had a new office building constructed in another state for use as its new corporate headquarters.

Required:

a. Which of the above expenditures should be capitalized? How should each be depreciated or amortized? Discuss the rationale for your answers.

b. How would the sale of the land and building be accounted for? Include in your answer how to determine the net book value at the date of sale. Discuss the rationale for your answer.

Number 3 (Estimated time —— 15 to 25 minutes)

The Michael Company is accounting for a long-term construction contract using the percentage-of-completion method. It is a four-year contract that is presently in its second year. The latest estimates of total contract costs indicate that the contract will be completed at a profit to Michael Company.

Required:

a. What theoretical justification is there for Michael Company's use of the percentage-of-completion method?

b. How would progress billings be accounted for? Include in your discussion the classification of progress billings in the Michael Company financial statements.

c. How would the income recognized in the second year of the four-year contract be determined using the cost-to-cost method of determining percentage of completion?

d. What would be the effect on earnings per share in the second year of the four-year contract of using the percentage-of-completion method instead of the completed-contract method? Discuss.

Number 4 (Estimated time —— 15 to 25 minutes)

Selected information from the financial statements of the Pace Company follows:

Pace Company
CURRENT ASSETS SECTION OF BALANCE SHEETS

	December 31, 1982	December 31, 1981
	(000 omitted)	
Cash	$ 7,000	$ 7,200
Marketable securities, at cost which approximates market	26,000	22,000
Accounts receivable, net of allowance for doubtful accounts	210,000	190,000
Inventories	252,000	308,000
Prepaid expenses	5,000	4,800
Total current assets	$500,000	$532,000

Pace Company
STATEMENTS OF INCOME

	Year ended December 31, 1982	Year ended December 31, 1981
	(000 omitted)	
Net sales	$1,200,000	$1,000,000
Costs and expenses:		
Cost of goods sold	960,000	800,000
Selling, general and administrative expenses	147,000	120,000
Other, net	24,000	18,300
Total costs and expenses	1,131,000	938,300
Income from continuing operations before income taxes	69,000	61,700
Income taxes	26,900	25,300
Income from continuing operations	42,100	36,400
Cumulative effect of change in estimates of salvage values of property, plant, and equipment, less applicable income taxes of $1,500,000	—	3,000
Net income	$ 42,100	$ 33,400
Earnings per share of common stock:		
Income from continuing operations	$ 4.21	$ 3.64
Cumulative effect of change in estimates of salvage values of property, plant, and equipment, less applicable income taxes	—	.30
Net income	$ 4.21	$ 3.34

Selected information from the notes to the financial statements of the Pace Company is as follows:

[From Summary of Significant Accounting Policies]

Inventories — Inventories are stated at the lower of cost (first-in, first-out) or market.

Deferred Income Taxes — Deferred income taxes arise from timing differences when profits or expenses are included in taxable income on the income tax return later or earlier than they are included in the statement of income. Such timing differences principally relate to depreciation.

A provision for deferred income taxes of $6,700,000 in 1982 and $6,300,000 in 1981 is included in the statements of income in "other, net."

[From Notes to Financial Statements]

Inventories — Inventories are comprised of the following:

	December 31,	
	1982	*1981*
	(000 omitted)	
Finished goods	$176,000	$215,000
Goods in process	13,000	14,000
Raw materials	63,000	79,000
	$252,000	$308,000

Inventories at December 31, 1982, were reduced from a cost of $292,000,000 to a market value of $252,000,000 using the direct inventory reduction method. The cost of inventories at December 31, 1981, approximated their market value.

Accounting Change — During the third quarter of 1981, Pace Company revised earlier estimates of salvage values for its property, plant, and equipment. This change in accounting reduced the 1981 net income by $3,000,000 ($0.30 per share).

Required:

a. Are inventories and the related cost of goods sold presented appropriately? Explain why or why not. If the presentation is not appropriate, specify the appropriate presentation and explain why.

b. 1. What are the components of the quick (acid-test) ratio?

2. How should the quick (acid-test) ratio be used?

c. Is the provision for deferred income taxes presented appropriately? Explain why or why not. If the presentation is not appropriate, specify the appropriate presentation and explain why.

d. Is the accounting change presented appropriately? Explain why or why not. If the presentation is not appropriate, specify the appropriate presentation and explain why. Assume that the accounting change did not involve deferred income taxes.

Number 5 (Estimated time —— 15 to 25 minutes)

On January 1, Borman Company, a lessee, entered into three noncancelable leases for brand new equipment, Lease J, Lease K, and Lease L. None of the three leases transfers ownership of the equipment to Borman at the end of the lease term. For each of the three leases, the present value at the beginning of the lease term of the minimum lease payments, excluding that portion of the payments representing executory costs such as insurance, maintenance, and taxes to be paid by the lessor, including any profit thereon, is 75% of the excess of the fair value of the equipment to the lessor at the inception of the lease over any related investment tax credit retained by the lessor and expected to be realized by the lessor.

The following information is peculiar to each lease:

- Lease J does not contain a bargain purchase option; the lease term is equal to 80% of the estimated economic life of the equipment.
- Lease K contains a bargain purchase option; the lease term is equal to 50% of the estimated economic life of the equipment.
- Lease L does not contain a bargain purchase option; the lease term is equal to 50% of the estimated economic life of the equipment.

Required:

a. How should Borman Company classify each of the three leases above, and why? Discuss the rationale for your answer.

b. What amount, if any, should Borman record as a liability at the inception of the lease for each of the three leases above?

c. Assuming that the minimum lease payments are made on a straight-line basis, how should Borman record each minimum lease payment for each of the three leases above?

Index

HOW TO USE THIS INDEX: This index presents examination question number references for the four sections of the CPA examination — Accounting Practice Parts I and II, Auditing, Business Law, and Accounting Theory. 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 month (May, Nov.) and year (82, 83) precede the question numbers, which are followed by a dash and the page number in this book. The letter M following question numbers indicates a multiple choice item. For example, the reference M82: 15M-39 means May 1982, multiple choice item number 15 on page 39; the reference N82: 3-105 means November 1982, essay or problem number 3 on page 105. Note that, in the Accounting Practice section, no distinction has been made between parts I and II.

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X. Federal Taxation — Corporations and Partnerships.
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B. Departures from GAAP .... None

C. Conceptual Framework .... May 82: 14M-52, 15M-52, 33M-54
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G. Comparative Financial Statements .... None

H. Consolidated Financial Statements .... May 82: 12M-52, 18M-52
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May 83: 8M-168, 9M-168, 13M-169
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C. Deferred Income Tax Liabilities .... May 83: 20M-169

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III. Valuation, Recognition, and Presentation of Liabilities in Conformity with GAAP (cont.)

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May 83: 23M-170, 24M-170, 25M-170, 30M-170
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F. Long-Term Notes Payable .... None

G. Contingent Liabilities and Commitments .... May 82: 5M-51
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IV. Ownership Structure, Presentation, and Valuation of Equity Accounts in Conformity with GAAP.

A. Preferred and Common Stock .... May 83: 3-174

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A. Sales or Revenues .... May 82: 2-56
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D. Provision for Income Tax .... May 82: 4-59
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V. Measurement and Presentation of Income and Expense Items, Their Relationship to Matching and Periodicity, and Their Relationship to GAAP (cont.)

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J. Analysis of Financial Statements .... May 82: 3-57
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K. Development Stage Enterprises .... None

L. Personal Financial Statements .... None

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A. Nature of Cost Elements .... May 82: 5-59
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H. Absorption and Direct Costing .... May 82: 43M-55, 45M-55
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I. Transfer Pricing .... None

J. Product Pricing .... None

K. Budgeting and Flexible Budgeting .... Nov. 82: 46M-112
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L. Breakeven and Cost-Volume-Profit Analysis .... May 82: 47M-55, 50M-55
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M. Gross Profit Analysis .... None

N. Differential Cost Analysis .... None

O. Capital Budgeting Techniques .... May 82: 46M-55, 49M-55
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Nov. 82: 47M-112, 49M-112
May 83: 50M-172
Nov. 83: 50M-229

VIII. Not-for-Profit and Governmental Accounting.

A. Conceptual Framework .... None

B. Fund Accounting .... May 82: 53M-56, 54M-56, 55M-56
Nov. 82: 51M-112, 52M-112, 53M-112
May 83: 51M-172, 52M-172, 53M-173
Nov. 83: 51M-229, 52M-229, 53M-229

C. Types of Funds and Fund Accounts .... May 82: 51M-55, 52M-55, 56M-56, 57M-56, 58M-56
Nov. 82: 54M-112, 55M-113, 56M-113, 57M-113, 58M-113
May 83: 54M-173, 55M-173, 56M-173, 57M-173, 58M-173
Nov. 83: 54M-229, 55M-229, 56M-229, 57M-230

Accounting Theory — Content Specification Outline (cont.)

VIII. Not-for-Profit and Governmental Accounting (cont.)

D. Presentation of Financial Statements for Various Not-for-Profit and Governmental Organizations .... Nov. 83: 58M-230

E. Various Types of Not-for-Profit and Governmental Organizations .... May 82: 59M-56, 60M-56
Nov. 82: 59M-113, 60M-113
May 83: 59M-173, 60M-173
Nov. 83: 59M-230, 60M-230

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