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Uniform CPA examination preparation guide

American Institute of Certified Public Accountants. Examinations Division

American Institute of Certified Public Accountants. Board of Examiners

American Institute of Certified Public Accountants. Preparation Subcommittees

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AICPA

American
Institute of
Certified
Public
Accountants

AICPA Board of Examiners

Uniform CPA Examination Preparation Guide

AICPA Board of Examiners

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Preface

This Guide is a valuable tool for those who write and evaluate questions for the Uniform CPA Examination, and may be useful to accounting educators and others who develop written examinations. The Guide serves several purposes. First, it explains the context for preparing and using the Uniform CPA Examination. Second, it describes a conceptual framework for establishing the validity of the Uniform CPA Examination for licensing and how question writing fits into this framework. Third, it identifies various types of questions used on the Examination and presents guidelines for writing good questions, complete with illustrations.

The Guide is divided into seven chapters. Chapter 1 sets the context of the Uniform CPA Examination and describes its purpose. Chapter 2 considers factors involved in developing licensing examinations. Chapters 3–5 provide guidelines for writing questions, accompanied by illustrations. Chapter 6 presents a set of style and editorial guidelines used on the Uniform CPA Examination and Chapter 7 sets out the content specifications that are effective with the May 1996 Uniform CPA Examination.

Good question writing is both a technology and an art. The word *guide*, rather than *rules*, was chosen to describe this manual because many of the guidelines described in Chapters 3–5 have reasonable exceptions, depending on the purpose and context in which they are used. The guidelines provide a framework for helping the writer decide when to make exceptions. Using the Guide will improve question writers' skills and examination evaluators' judgments in critiquing and editing Uniform CPA Examination questions.

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Introduction to the Uniform CPA Examination

The Uniform CPA Examination is a licensing examination used by boards of accountancy to assess whether candidates have the requisite knowledge and skills to become certified public accountants (CPAs). States license CPAs to protect the public from unqualified and incompetent individuals who otherwise might offer public accountancy services.

OBJECTIVE OF THE UNIFORM CPA EXAMINATION

The objective of the Uniform CPA Examination is to assure boards of accountancy that CPAs entering the profession have passed an examination that *uniformly* tests necessary technical knowledge and skills at a common level of difficulty. It also assures that the Examination is graded under uniform standards and conditions. This means the Examination is a consistent and equitable tool in the licensing of CPAs. As such, it serves as a cornerstone for reciprocal licensing.

HISTORY

Since 1917, the American Institute of Certified Public Accountants (AICPA) has offered the Uniform CPA Examination to those jurisdictions that require a candidate to pass an examination before being licensed to practice public accountancy as a CPA. Currently, 54 U.S. jurisdictions – the 50 states, the District of Columbia, Puerto Rico, Guam, and the U.S. Virgin Islands – require CPA candidates to pass the Examination before becoming licensed.

Many of these jurisdictions have adopted, in substance, the Uniform Accountancy Act, which includes common standards for education and experience as well as for the Uniform CPA Examination. When more jurisdictions adopt the provisions in the Act for initial licensure, uniformity in standards for new CPAs will be further enhanced.

Since 1968, the number of CPA candidates has increased from about 36,000 to about 140,000 in 1993. Because the Uniform CPA Examination is a multi-section examination, the number of papers graded each year is much larger than the number of candidates and has increased from 129,000 in 1968 to 517,000 in 1993, an increase of over 300%. The total number of papers graded is far greater than that of any other professional licensing examination in the United States.

BOARD OF EXAMINERS

The volunteer members of the AICPA Board of Examiners and its subcommittees have primary responsibility for preparing and grading the Uniform CPA Examination. The Board of Examiners consists of nine AICPA members. Reporting to the Board of Examiners are four preparation subcommittees—one for each section of the Examination—and a standard setting subcommittee. The volunteers are primarily subject matter experts from large and small public accounting firms and academia, and are geographically diverse.

The Board of Examiners is supported by a full-time professional staff working in the AICPA Examinations Division, including CPA and attorney specialists who administer the Examination's development and grading processes, draft questions, and prepare the Examination. The Examination Division also includes testing specialists, design and production specialists, and its own grading and shipping staff. Using these resources, the Board of Examiners oversees the Examination process from initial development to grade reporting.

Designing Quality Licensure Examinations

Regulatory boards use examinations as part of a licensure or credentialing process mandated by state law. Those boards are obligated both to the public and to candidates for licensure to use examinations that can distinguish fairly between candidates who meet appropriate minimum requirements for the profession and those who do not. There is a substantial body of testing theory available to guide preparers of examinations, and many constraints on what is appropriate to test on a licensure examination. This chapter presents some basics of testing theory and relates them to the development of the Uniform CPA Examination.

The importance of careful test preparation is emphasized in the following statement from the Council on Licensing, Enforcement, and Regulation (CLEAR).

Examinations for credentialing are by their nature “high stakes,” meaning that the consequences of a mistake on the part of the examiner or candidate are significant, namely the delay or elimination of the candidate from practice. Failure on the part of an agency to observe the technical foundations of testing may result in errors such as the denial of credentialing to a competent candidate or the credentialing of an incompetent candidate. (CLEAR, 1993, p. 1)

Examinations used for licensing individuals must test knowledge and skills directly related to the performance of the activities being licensed. Although this seems obvious, it is difficult to defend the content of an examination without well-documented evidence that the questions actually relate to the practice being licensed. The requirement for “practice-relatedness” also implies that many things *cannot* be asked on a licensure examination. Consider the following:

Given the purpose of licensure examinations—to establish evidence of competence to practice at entry level—it is critical that the examination be practice-related. The examination should assess those qualities—knowledge and skills—that reflect the competence the licensee needs to ensure that the public is not affected adversely. For example, selling skills, while clearly related to *success* in an insurance career, are not relevant for licensing purposes. Questions testing selling skills would be inappropriate in a licensure examination for insurance agents.

Similarly, it also would be inappropriate to test information that might be desirable from an academic perspective, or included in a training program for an occupation, but that is not critical to doing the job at a beginning level. For example, knowing who developed the dual-entry accounting system may be considered important by professors in a school of accountancy, and might even provide an accountant with interesting conversational material, but such facts have little relevance to licensure. The absence of that knowledge will not affect a CPA's ability to set up or audit an accounting system in conformity with the standards of the profession or the laws of the state (Burns, pp. 16-17).

PRACTICE ANALYSIS OF CPAs

Subject matter covered on licensure examinations must come from the field of practice. The AICPA has conducted extensive studies of public accounting practice to determine the specific knowledge and skills that may be included on the Uniform CPA Examination. The results of those research efforts are condensed in the content specifications for the Uniform CPA Examination, presented in Chapter 7. Those specifications summarize the subject matter that can appropriately be covered on the Uniform CPA Examination.

VALIDITY

Validity refers to the ability to make supportable inferences and decisions from examination scores. Professional licensing examinations must help regulatory boards decide whether candidates have the knowledge and skills needed for entry into the profession. A licensing examination's validity is generally supported by a body of evidence that the examination, taken as a whole, assesses knowledge and skills that are needed for public protection. The knowledge and skills are first specified and then represented in formal content specifications. This means that for the Uniform CPA Examination to be valid it should test a representative sample of the knowledge and skills identified in the content specifications.

EXAMINATION SPECIFICATIONS

Examination specifications represent a blueprint for a particular examination. For the Uniform CPA Examination, the examination specifications serve as the framework from which an examination is assembled. Examination specifications should describe the subject matter covered, formats, level of cognitive complexity, and difficulty level. Uniform CPA Examination preparers are guided by criteria regarding format and content that apply to each new examination version.

EXAMINATION STRUCTURE AND FORMAT

The Uniform CPA Examination spans 15½ hours over two days, and consists of four separate sections:

- Auditing (AUDIT)
- Financial Accounting & Reporting (FARE)
- Accounting & Reporting – Taxation, Managerial, and Governmental and Not-for-Profit Organizations (ARE)
- Business Law & Professional Responsibilities (LPR)

Candidates must pass all four sections to fulfill the examination requirement for licensing in all jurisdictions.

The Board of Examiners has mandated that each examination section consist of a range of questions using several formats. Examination formats can be summarized as objective or essay. Each format includes several variations described in more detail in Chapters 3–5. The percentage of each format that may be used on each section of the Examination is presented in the following table. Note that objective questions are subdivided into four-option multiple-choice and other objective answer formats (OOAFs).

	<i>AUDIT</i>	<i>FARE</i>	<i>ARE</i>	<i>LPR</i>
<i>Four-option multiple choice</i>	50–60%	50–60%	50–60%	50–60%
<i>OOAFs</i>	20–30%	20–30%	40–50%	20–30%
<i>Essay</i>	20–30%	20–30%	NONE	20–30%

There is no simple method for selecting the best format to measure particular knowledge and skills. Factors such as testing time, administrative feasibility, and the time available to prepare and grade an examination must be weighed when selecting formats.

TYPES OF FORMATS

Objective Formats. A format is considered objective when it can be graded without subjectivity. Grading objective examinations is a mechanical process that requires little judgment. Any format that can be graded by machine is generally considered objective. Objective formats result in very consistent scores because the acceptability of particular responses is determined before grading begins.

The most widely used objective format is multiple-choice, because it has a restricted set of alternatives from which the correct answer must be selected. Variations of the multiple-choice format are discussed in more detail in Chapter 3.

Other objective answer formats (OOAFs) include *constructed response (numeric)*, *matching*, *graphic*, and *multiple yes-no* formats. The numerical constructed response format requires candidates to enter quantitative responses to open-ended questions in a way that is machine-readable. The matching format requires candidates to select the correct or best answer to a set of questions from a common list of options that may be extensive, even exhaustive. Graphic formats require candidates to interpret information presented in graphic form and to use this information to answer a series of questions. The multiple yes-no format requires candidates to indicate whether each response option pertains to the stem. This differs from the multiple-choice format, which requires candidates to select the one correct or best answer from a list of four options. OOAF formats are discussed further in Chapter 4.

Essay Formats. Essay formats used on the Uniform CPA Examination include both essays and problems. Essays require candidates to formulate a written response to a requirement, typically related to a specific set of facts presented in the question. Problems generally require candidates to prepare a document or report similar to one that might be developed in practice. In answering essays and problems, candidates will describe the solution to a problem in narrative form, develop financial statements, write letters or memos to various parties, and create other work products. Essay formats are discussed further in Chapter 5.

Advantages and Disadvantages of Objective and Essay Formats. The major advantages of objective formats compared with essay formats are that they —

- grade more objectively and consistently
- generally test understanding and application skills more efficiently
- grade quickly and relatively inexpensively

The major advantages of essay formats compared with objective formats are that they —

- require candidates to formulate answers and communicate them in writing
- test evaluation skills more effectively
- are less susceptible to guessing the correct answer
- generally are easier to prepare

The major disadvantages of objective formats compared with essay formats are that they —

- test evaluation skills less effectively
- are more susceptible to guessing the correct answer
- generally are more difficult to prepare

The major disadvantages of essay formats compared with objective formats are that they —

- generally are more time-consuming and costly to grade
- are susceptible to bluffing the right answer
- are more difficult to grade consistently

LEVELS OF COGNITIVE COMPLEXITY

The Uniform CPA Examination is designed to assess important candidate knowledge using skills at different levels of cognitive complexity. Skills targeted for assessment on the Uniform CPA Examination are classified into one of three levels of cognitive complexity:

1. **Understanding**— The ability to recognize or recall learned material and to grasp its meaning.
2. **Application**— The ability to use learned material in novel situations by relying on the principles that underlie the material.
3. **Evaluation**— The ability to extract relevant information from a context, draw conclusions, make appropriate professional decisions, and communicate their judgments to a variety of audiences.

EXAMINATION DIFFICULTY

The Uniform CPA Examination is designed to have an appropriate level of difficulty for new CPAs. On average, the questions that make up the Uniform CPA Examination are targeted to be moderately difficult for new CPAs, with some easier and some more difficult. Most Examination questions are designed so that between 60% and 80% of entry-level CPAs (not CPA *candidates*) would get them correct, although some questions will fall outside this range. At this level of Examination difficulty, candidates who possess about 75% of the knowledge assessed on any section of the Uniform CPA Examination will pass.

CONCEPTUAL FACTORS IN EXAMINATION DEVELOPMENT

There is a complex interaction among content, type of format, level of cognitive complexity, and question difficulty. When developing an examination, focusing on any one of these conceptual factors likely will affect the others. For example, changing the format of a question may affect its level of complexity, its difficulty, and whether it still fits into the examination specifications. Though there are no strict rules about what happens when one of the four conceptual factors is changed, the AICPA Examinations Division staff has noted some trends. These trends are consistent in Uniform CPA Examinations as a whole, but they may not apply to any particular question.

As cognitive complexity increases:

- difficulty tends to increase
- fact patterns tend to become longer
- skills that are generally developed with experience tend to be assessed

As difficulty level increases:

- knowledge that is esoteric or less important than the targeted knowledge tends to be assessed

As the format becomes more elaborate:

- statistical consistency tends to decrease
- difficulty tends to increase

GUIDELINES FOR SELECTING QUESTION FORMATS

The following guidelines for selecting examination formats are based on the work of Gronlund (1979) and Osterlind (1989), and may be helpful in deciding which format is most appropriate for a particular examination objective.

1. If the objective is to assess understanding, objective formats are *much* more efficient than essay formats. This is particularly true of multiple-choice and, sometimes, matching and multiple yes-no formats.
2. If the target knowledge or skill can be measured appropriately with the multiple-choice format, then this format should be used. Not only can the multiple-choice format test a wide range of content efficiently, but its statistical characteristics are the most researched and best understood.

3. If there are several responses that could be used to answer a multiple-choice question correctly, matching and multiple yes-no formats should be considered. These more elaborate formats are designed to assess candidates' knowledge and skills for relating facts or processes.
4. The matching format should be considered when an exhaustive set of responses can be identified and logically grouped or ordered. For example, a series of financial statement entries, tax return entries, or auditor opinions can be used as answer choices for a series of questions, each of which is to be associated with one of the listed options. The length of the list of options may be limited by practical constraints; however, this format is least affected by guessing when the list contains all reasonable alternatives. To reduce the undesirable effects of long lists, options should be grouped logically or, for numerical options, listed in ascending order.
5. Essays and problems should be used whenever the focus of the assessment is the ability to formulate or supply, rather than select, the answer. If the answers to be provided by the candidate are numbers, then the constructed response (numeric) format may be appropriate.
6. Essays and problems should be used when trying to measure candidates' skills in explaining, describing, evaluating, or relating concepts. These skills are not measured directly or easily using objective item formats.
7. Essays and problems should be considered when the intent is to give candidates partial credit for less-than-perfect responses. Because grading essay formats is less mechanical than grading objective formats, credit for portions of answers may be given. Typically, on the Uniform CPA Examination, candidates receive a range of credit on essays and problems reflecting the degree of completeness and accuracy of the answer. For example, the grader could carry through all calculation errors and give credit if further calculations consistently use the incorrect value calculated earlier in the problem.

STEPS IN PREPARING THE UNIFORM CPA EXAMINATION

First, examination specifications for each section are prepared by Examinations Division staff and reviewed by the appropriate preparation subcommittee. After modifications, if needed, are made, the preparation subcommittee approves the examination specifications. The Board of Examiners then reviews all four sets of examination specifications for conformity with the content specifications, balance of coverage, relevance to the practice of public accounting, and appropriateness of format. When the examination specifications meet these criteria, the Board of Examiners approves them.

Three drafts of each Uniform CPA Examination are reviewed by the preparation subcommittees for the following:

- Conformity with the examination specifications
- Technical accuracy supported by authoritative documentation
- Relevance to the practice of public accounting
- Appropriateness of the level of cognitive complexity for CPAs entering the profession
- Appropriateness of the level of difficulty for CPAs entering the profession

After each review the examination draft is revised at the preparation subcommittee's direction. Members of the Board of Examiners review all fourth and final examination drafts and must approve them before the examination goes to press. The members of the preparation subcommittees also review and approve the final examination draft of the section for which they are responsible.

In addition to the Board of Examiners and preparation subcommittee reviews, technical reviews of each draft are performed by AICPA Examinations Division staff. Testing specialists—known as psychometricians—review each examination draft for conformance with accepted testing standards and the guidelines presented in the succeeding chapters of the Guide. The psychometric review also focuses on possible structural flaws that would allow a candidate who does not know the answer to respond correctly. Each draft is reviewed for technical accuracy and compliance with examination style/editorial guidelines by a CPA other than the technical manager who prepares each examination section. The final draft of each examination section is also reviewed by three other technical managers who did not take part in the development of that section. In addition to these reviews, the final examination draft is read by a professional proofreader.

The preparation process is vital to the validity of the Uniform CPA Examination because it ensures that the examination embodies the subject matter identified in the content specifications. The process also ensures that the examination is technically accurate and appropriate for entry-level CPAs. At the heart of the examination preparation process is writing questions. Although most readers of the *Uniform CPA Examination Preparation Guide* have the technical training and experience to write or evaluate examination questions in the subject matter covered on the Uniform CPA Examination, many are novices to the art and technology of writing examination questions. The remainder of this guide details guidelines for writing Uniform CPA Examination questions using various types of formats. These guidelines also will be helpful to editors and reviewers who evaluate examinations and their component questions.

Multiple-Choice Formats

A multiple-choice question consists of two distinct parts:

- **The Stem.** Candidates are provided with information in a scenario, or set of facts, in the stem. The stem may ask a question or require the candidate to complete a sentence. Another term for the stem of a multiple-choice item is the *fact pattern*.
- **Response Options.** Candidates have to choose among options based on the information provided in the stem. Only one of these options should be correct or clearly best. This is called the *key option*, or simply the *key*. The other options, all of which should be incorrect or clearly inferior to the key, are called *distractors*. As the name implies, distractors are incorrect options designed to be plausible to a candidate who does not have the knowledge or skill required to identify the correct option.

A NOTE ON DISTRACTOR DIFFICULTY

Distractors should not attract well-prepared candidates who have the knowledge and skill being assessed. The appropriateness of each distractor has a direct effect on the difficulty of the item. When plausible distractors are used, and the key response is clearly the *correct* or *best* answer, then the distractors should attract only the less knowledgeable candidates. However, if the distractors are closely related to the correct answer, or if they assess unusual exceptions to rules, knowledgeable candidates may be fooled *even more frequently* than those who guess. Special care should be taken to ensure that the distractors are not too plausible to knowledgeable candidates, especially when new, obscure, or highly technical material is being assessed.

Example:

During 1995, Lyle Co. incurred \$400,000 of research and development costs in its laboratory to develop a product for which a patent was granted on July 1, 1995. Legal fees and other costs associated with the patent totaled \$82,000. The estimated economic life of the patent is 10 years. What amount should Lyle capitalize for the patent on July 1, 1995?

Stem

- A. \$0
- B. \$ 82,000
- C. \$400,000
- D. \$482,000

Distractor

Key

Distractor

Distractor

The four-option multiple-choice question is the predominant format used on the Examination, representing 50% to 60% of the points available on each of the four Examination sections. Each multiple-choice question is used to test a particular knowledge or skill identified in the Uniform CPA Examination's content specifications at a particular level of cognitive complexity. For example, the question above is intended to assess knowledge of accounting for patents at the cognitive level of understanding.

TYPES OF MULTIPLE-CHOICE QUESTIONS

Within the multiple-choice format, questions can be presented in different ways. For example, the amount of information presented in an item's fact pattern can be limited or extensive. Also, the number of items using one fact pattern can vary. Following are examples of common multiple-choice items. Correct answers are designated by an asterisk(*).

Basic. The basic multiple-choice question has a short stem and a single correct response. This is the most common multiple-choice question format used on the Examination. A limited amount of information is presented in the stem, and a single set of response options is presented to the candidates. The following example of a basic multiple-choice question is targeted to assess knowledge of governmental accounting at the cognitive level of application.

Example:

At December 31, 1995, the following balances were due from the state government to Clare City's various funds:

Capital projects	\$300,000
Trust and agency	100,000
Enterprise	80,000

In Clare City's December 31, 1995, combined balance sheet for all fund types and account groups, what amount should be classified under governmental funds?

- A. \$100,000
- B. \$180,000
- C. \$300,000*
- D. \$480,000

Extended. Extended multiple-choice questions are similar to the basic multiple-choice question but differ in that more information is included in the stem and more than one question is based on this information. This format can be used when several independent questions can be related to a single set of facts. Following is an example of a fact pattern related to three multiple-choice questions. It is targeted to assess candidates' knowledge of the law relating to mortgage transactions at the cognitive level of understanding.

Example:

Questions 1, 2, and 3 are based on the following information:

On February 1, Frost bought a building from Elgin, Inc. for \$250,000. To complete the purchase, Frost borrowed \$200,000 from Independent Bank and gave Independent a mortgage for that amount; gave Elgin a second mortgage for \$25,000; and paid \$25,000 in cash. Independent recorded its mortgage on February 2 and Elgin recorded its mortgage on March 12.

The following transactions also took place:

- On March 1, Frost gave Scott a \$20,000 mortgage on the building to secure a personal loan Scott had previously made to Frost.
- On March 10, Scott recorded this mortgage.
- On March 15, Scott learned about both prior mortgages.
- On June 1, Frost stopped making payments on all the mortgages.
- On August 1, the mortgages were foreclosed. Frost, on that date, owed Independent \$195,000; Elgin \$24,000; and Scott \$19,000.

A judicial sale of the building resulted in proceeds of \$220,000 after expenses were deducted. The above transactions took place in a notice-race jurisdiction.

1. What amount of the proceeds will Scott receive?
 - A. \$0
 - B. \$ 1,000
 - C. \$12,500
 - D. \$19,000*
2. Why would Scott receive this amount?
 - A. Scott knew of the Elgin mortgage.
 - B. Scott's mortgage was recorded before Elgin's and before Scott knew of Elgin's mortgage.*
 - C. Elgin's mortgage was first in time.
 - D. After Independent is fully paid, Elgin and Scott share the remaining proceeds equally.
3. Frost may redeem the property before the judicial sale only if
 - A. There is a statutory right of redemption.
 - B. It is probable that the sale price will result in a deficiency.
 - C. All mortgages are paid in full.*
 - D. All mortgagees are paid a penalty fee.

Roman Type. Another variation of the basic multiple-choice question is the Roman type. In this format, the candidate is presented with several statements, each preceded by a code, usually a Roman numeral. This differs from the multiple-choice questions already discussed in that the response options may require the candidate to know or derive several pieces of related information. The task for the candidate is to select the option that represents the correct combination of statements. The following example targets candidates' understanding of estate taxes.

Example:

Which of the following is(are) deductible from a decedent's gross estate?

- I. Expense of administering and settling the estate.
- II. State inheritance or estate tax.
 - A. I only.*
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

Columnar Type. This is a variation of the Roman-type question. The stem of this format is similar to the basic multiple-choice question; however, the response options require the candidate to identify the correct answers in each column. Columnar-type questions contain two or three columns. The columnar-type format works best when the columns represent related knowledge and the relationship among them is sufficiently important to assess. The following example is aimed at testing candidates' ability to apply their understanding of accounting for notes payable.

Example:

Ames, Inc. has \$500,000 of notes payable due June 15, 1996. Ames signed an agreement on December 1, 1995, to borrow up to \$500,000 to refinance the notes payable on a long-term basis with no payments due until 1997. The financing agreement stipulated that borrowings may not exceed 80% of the value of the collateral Ames was providing. At the date of issuance of the December 31, 1995, financial statements, the value of the collateral was \$600,000 and was not expected to fall below this amount during 1996. In Ames' December 31, 1995, balance sheet, the obligation for these notes payable should be classified as

	<u>Short-term</u>	<u>Long-term</u>
A.	\$500,000	\$0
B.	\$100,000	\$400,000
C.	\$ 20,000	\$480,000*
D.	\$0	\$500,000

GUIDELINES FOR WRITING MULTIPLE-CHOICE QUESTIONS

The Board of Examiners has adopted a set of guidelines for writing multiple-choice questions for the Uniform CPA Examination. The term *guidelines*, rather than *rules*, was chosen carefully. Although these guidelines apply in most situations, there may be specific testing objectives that warrant a departure from the guidelines. However, in such situations, departure from the guidelines should be justified.

The list is based on reviews from the educational measurement literature (Haladyna and Downing, 1988a; 1988b), practices described in measurement texts (Gronlund, 1981; Millman & Greene, 1989; Osterlind, 1989), and the experiences of AICPA staff. Following the list, the guidelines are described in detail.

General Guidelines

1. Use good grammar, punctuation, and spelling.
2. Use either the "correct answer" or "best answer" format.
3. Avoid trick questions that mislead or deceive candidates into answering incorrectly.
4. Test important knowledge and skills included in the examination specifications; do not test trivial or obscure knowledge.
5. Keep questions independent of one another; do not cue the answer to one question with another.
6. In phrasing each question, minimize candidate reading time.
7. Use vocabulary at a level appropriate for entry-level CPAs.
8. Avoid complex multiple-choice formats unless dictated by the knowledge and skill requirements in the examination specifications.
9. Minimize the difficulty of calculations.

Stem Construction Guidelines

10. In general, use the question format because it generally is less ambiguous than the completion format.
11. Write the directions in the stem clearly, using language that lets candidates know exactly what is being asked.
12. Avoid “window dressing” (extraneous material) in the stem unless dictated by the skill being assessed.
13. Avoid cuing through the use of faulty grammatical construction.
14. Avoid negative phrasing in the question portion of the stem.

Response Option Construction Guidelines

15. Make sure that there is only one “correct” or “best” option.
16. Place response options in logical or numerical order, when appropriate; otherwise, order them randomly.
17. Keep option length consistent.
18. Keep all options in a question homogeneous in content.
19. Avoid specific determiners, such as *all*, *none*, *always*, and *never*.
20. Avoid using *all of the above* or *none of the above* as options except in Roman-type and columnar-type questions.

Distractor Construction Guidelines

21. Use plausible distractors.
22. Incorporate common candidate errors in distractors whenever possible.
23. Avoid humorous options.

DISCUSSION OF ITEM WRITING GUIDELINES

General Guidelines

1. **Use good grammar, punctuation, and spelling.** Follow the style guidelines presented in this guide. The grammatical construction of the questions reflects on the overall quality of the Examination. Review questions to ensure that the wording is not awkward, ambiguous, or confusing.
2. **Use either the “correct answer” or “best answer” format.** The correct responses for the multiple-choice questions used on the Examination generally fall into one of these two formats. Regardless of format, it is important that all questions adhere to guideline number 15 (make sure that there is only one “correct” or “best” option). The difference between these two formats is that the incorrect options in the *correct answer* format are clearly wrong, whereas the incorrect options in the *best answer* format may have varying degrees of correctness.

3. **Avoid trick questions that mislead or deceive candidates into answering incorrectly.** Good distractors are intended to be attractive to candidates who do not have the requisite knowledge or skill being assessed. If a distractor also attracts knowledgeable candidates, it often does so because it is misleading.

4. **Test for important knowledge and skills included in the examination specifications; do not test trivial or obscure knowledge.** Always remember that the purpose of the Uniform CPA Examination is to assess important knowledge and skills to ensure the protection of the public from incompetent practitioners. Questions that assess trivial or irrelevant knowledge interfere with making appropriate licensing decisions.

Example:

POOR

When submitting audited financial statements to a client, a CPA must comply with the provisions of Statement on Auditing Standards No.

- A. 28
- B. 38
- C. 48
- D. 58*

From a licensing perspective, whether candidates know specific Statements on Auditing Standards numbers is trivial. It is more pertinent that candidates know that there are professional standards that must be adhered to and the sources of authority for the standards. They should also understand the issues the standards address and how the standards are applied in specific circumstances.

IMPROVED

When compiling the financial statements of a nonpublic entity, an accountant should comply with the provisions of

- A. Statements on Standards for Accounting and Review Services.*
- B. Statements on Standards for Consulting Services.
- C. Statements on Auditing Standards.
- D. Statements on Standards for Attestation Engagements.

It is more pertinent to licensing that a CPA knows what the applicable standards are and how to apply them than to know each standard by its number.

5. **Keep questions independent of one another; do not cue the answer to one question with another.** Two questions that test the same knowledge provide redundant information that may detract from the validity of the resulting examination score. Also, information in the stem or response options of one question should not provide clues to the answer of another question.

Example:

- A. Charles and Marcia are married cash-basis taxpayers. In 1995, they had interest income as follows:

- \$500 interest on federal income tax refund.
- \$600 interest on state income tax refund.
- \$800 interest on federal government obligations.
- \$1,000 interest on state government obligations.

What amount of interest income is taxable on Charles and Marcia's 1995 joint income tax return?

- A. \$ 500
- B. \$1,100
- C. \$1,900*
- D. \$2,900

- B. During 1995, Loy received interest income as follows:

On U.S. Treasury certificates	\$3,000
On refund of 1993 federal income tax	200

The total amount of interest subject to tax in Loy's 1995 return is

- A. \$0
- B. \$ 200
- C. \$3,000
- D. \$3,200*

In this example, questions A and B are not independent because candidates who know the answer to question A will also know the answer to question B. Therefore, question B does not provide additional information regarding a candidate's knowledge.

6. **In phrasing each question, minimize candidate reading time.** Concise wording in both the stem and the options enhances the question's clarity and reduces candidates' reading time. A good rule of thumb is to use the simplest way to communicate information to a candidate without oversimplifying.

7. **Use vocabulary at a level appropriate for entry-level CPAs.** Unfamiliar jargon, overly complex sentences, and other writing errors can prevent a question from measuring the intended knowledge and skills.

Example:

POOR

Bronson is a domiciliary in tenancy with a 10-year written leasehold interest in the property. Which of the following premises is correct if the leasehold contract lacks provisions of specificity to the contrary?

- A. The premises may **not** be subtenanted for less than the fullness of the remainder of the leasehold period.
- B. Bronson may **not** make a voluntary assigning of the leasehold.
- C. The landlord's demise will instantaneously and contemporaneously be the terminus of the leasehold.
- D. Bronson's achieving of absolute ownership of the property will cause the termination of the leasehold.*

Many of the legal terms used in this question are beyond the scope of knowledge that most CPAs need in their practices.

IMPROVED

Bronson is a residential tenant with a 10-year written lease. Which of the following statements is generally correct with respect to Bronson's lease?

- A. The premises may **not** be sublet for less than the full remaining lease term.
- B. Bronson may **not** assign the lease.
- C. The landlord's death will automatically terminate the lease.
- D. Bronson's purchase of the property will terminate the lease.*

8. **Avoid complex multiple-choice formats unless dictated by the knowledge and skill requirements in the examination specifications.** Construct complex multiple-choice questions carefully. Such formats may provide cues to test takers, contain redundant information, or be confusing.

Example:

POOR

Ban Co.'s fiscal year end is December 31. Cash dividends on Ban's \$10 par value common stock were as follows:

1st quarter	\$ 800,000
2nd quarter	900,000
3rd quarter	1,000,000
4th quarter	1,100,000

The 4th quarter cash dividend was declared on December 20 to stockholders of record on December 31. Payment of the 4th quarter cash dividend was made on January 9 of the following year.

In addition, Ban declared a 5% stock dividend on its \$10 par value common stock on December 1, when there were 300,000 shares issued and outstanding and the market value of the common stock was \$20 per share. The shares were issued on December 21.

What was the effect on Ban's stockholders' equity accounts as a result of the above transactions?

	<u>Common stock</u>	<u>Additional paid-in capital</u>	<u>Retained earnings</u>
A.	\$0	\$0	\$3,800,000 debit
B.	\$150,000 credit	\$0	\$3,950,000 debit
C.	\$150,000 credit	\$150,000 credit	\$4,100,000 debit*
D.	\$300,000 credit	\$300,000 credit	\$3,800,000 debit

The format of the response options is difficult to follow because there are three separate pieces of information to read for each option. This increases the chances that a candidate having the requisite understanding of stockholders' equity will miss the correct answer. Conversely, this question would not be effective at testing the candidate's knowledge of the three aspects of stockholders' equity because a candidate could guess the correct answer simply by knowing the effects of the transactions on *either* additional paid-in capital or retained earnings. One or two of the columns should be deleted.

IMPROVED

Ban Co.'s fiscal year end is December 31. Cash dividends on Ban's \$10 par value common stock were as follows:

1st quarter	\$ 800,000
2nd quarter	900,000
3rd quarter	1,000,000
4th quarter	1,100,000

The 4th quarter cash dividend was declared on December 20 to stockholders of record on December 31. Payment of the 4th quarter cash dividend was made on January 9 of the following year.

In addition, Ban declared a 5% stock dividend on its \$10 par value common stock on December 1, when there were 300,000 shares issued and outstanding and the market value of the common stock was \$20 per share. The shares were issued on December 21.

By what amount was Ban's retained earnings account debited as a result of the above transactions?

- A. \$2,700,000
- B. \$3,800,000
- C. \$3,950,000
- D. \$4,100,000*

9. **Minimize the difficulty of calculations.** Based on the two practice analysis studies of CPAs in public accounting, a CPA's ability to make complex calculations is much less important than the ability to know how to do them. Thus, calculations should be made as simple as possible to assess a candidate's understanding of the calculation's purpose.

Beginning in May 1994, CPA candidates were provided with calculators at the examination sites to use on the Accounting & Reporting (ARE) and Financial Accounting & Reporting (FARE) sections. The purpose of providing calculators was to save the time candidates spend on performing and rechecking manual calculations; it was not intended to allow for more difficult and complex calculations and problems. The calculations required to answer objective and problem-type questions should be at the same level of complexity as they were before calculators were provided.

Stem Construction Guidelines

10. **In general, use the question format because it generally is less ambiguous than the completion format.** Although virtually all testing experts support the use of both formats, research on this topic suggests that the question format may lead to slightly better test reliability and validity. This is because the question format generally is less likely to be ambiguous. In the Examinations Division's experience, most ambiguous questions use the completion format. While this doesn't mean that the question format is always better than the completion format, it does suggest that if a stem can be worded as a question without making it convoluted or confusing, it probably should be. A good rule of thumb: if the stem can be written either as a question or a completion, and both seem equally clear and concise, use the question format.

The following two examples show the same basic question using the completion and question formats. Both seem to be equally clear. In this case, although they may seem to be equally clear to most candidates, the question format is preferred.

Example:

COMPLETION FORMAT

An auditor selects a sample from the file of shipping documents to determine whether invoices were prepared. This test is performed to satisfy the audit objective of

- A. Accuracy.
- B. Completeness.*
- C. Control.
- D. Existence.

QUESTION FORMAT

An auditor selects a sample from the file of shipping documents to determine whether invoices were prepared. What audit objective does this test satisfy?

- A. Accuracy.
- B. Completeness.*
- C. Control.
- D. Existence.

11. **Write the directions in the stem clearly, using language that lets candidates know exactly what is being asked.**

Example:

POOR

Failure to accrue interest on a note at the end of the current year would

- A. Overstate total revenue for the current year.
- B. Understate total liabilities at the end of the current year.
- C. Understate stockholders' equity at the end of the current year.
- D. Not affect net income for the current year.

In this example, it is not clear to the candidate whether the note is payable or receivable. If it were a note payable, the correct answer would be B. If it were a note receivable, the correct answer would be C. The stem would be improved by following "note" with either "payable" or "receivable."

12. **Avoid "window dressing" (extraneous material) in the stem unless dictated by the skill being assessed.** Window dressing, which is extraneous material in a question stem, is generally not recommended. If the examination objective is to test candidates' analytical skills, it may be proper to include some attractive but irrelevant information to assess whether the candidate can identify the information needed to solve the problem. Otherwise, extraneous material simply increases candidates' reading time and reduces clarity, limiting the question's value in assessing its original objective.

Example:

POOR

Ryan, age 57, is single with no dependents. In 1995, Ryan's principal residence was sold for the net amount of \$400,000 after all selling expenses. The selling expenses included the real estate broker's commission of \$20,000. Ryan bought the house in 1983 and occupied it until sold. On the sale date, the house had a basis of \$180,000. Home improvements for 1990 included a new bathroom costing \$10,000, and a new kitchen costing \$15,000. No depreciation was taken on the residence. Ryan does not intend to buy another

residence. What is the maximum exclusion of gain on the sale of the residence that may be claimed in Ryan's 1995 income tax return?

- A. \$220,000
- B. \$125,000*
- C. \$ 62,500
- D. \$0

The question may be reworded to shorten the candidate's reading time and to reduce the need to sort out irrelevant information.

IMPROVED

Ryan, age 57, is single with no dependents. In 1995, Ryan's principal residence was sold for the net amount of \$400,000 after all selling expenses. Ryan bought the house in 1983 and occupied it until sold. On the sale date, the house had a basis of \$180,000. Ryan does not intend to buy another residence. What is the maximum exclusion of gain on the sale of the residence that may be claimed in Ryan's 1995 income tax return?

- A. \$220,000
- B. \$125,000*
- C. \$ 62,500
- D. \$0

13. **Avoid cuing through the use of faulty grammatical construction.** Items may be made needlessly easy or confusing when the correct or incorrect answers are cued by grammatical errors or inconsistencies.
14. **Avoid negative phrasing in the question portion of the stem.** Word the stem positively. Research shows that negatively worded stems can make items unnecessarily complex and difficult. Equally important, negatively worded stems assess not what candidates know to be true, but what they know to be false. While this may be an appropriate objective, usually the objective is to test what candidates know to be true. While negatively worded stems are often easier to construct than positively worded ones, this should not determine how to structure an item. Whenever you write (or evaluate) a negatively worded question, ask yourself, "Is the objective to assess what is known to be false?" Most of the time you will rewrite the item.

Example:

POOR

Which of the following is **not** a reason an auditor should obtain an understanding of the elements of an entity's internal control structure in planning an audit?

- A. To identify the types of potential misstatements that can occur.
- B. To design substantive tests.
- C. To consider the operating effectiveness of the internal control structure.*
- D. To consider factors that affect the risk of material misstatements.

Some candidates could get the correct answer because they know that C is not a reason to understand an entity's internal control structure. Thus, candidates who don't know that A, B, and D were all good reasons could get the answer correct if they clearly understood C to be a bad reason. This question has been revised to better assess whether candidates know why it is important for an auditor to understand the elements of an entity's internal control structure.

IMPROVED

Which of the following is a reason an auditor should obtain an understanding of the elements of an entity's internal control structure in planning an audit?

- A. To identify the types of potential misstatements that can occur.*
- B. To measure the sufficiency of the evidential matter obtained.
- C. To consider the operating effectiveness of the internal control structure.
- D. To eliminate subjectivity in the evaluation of sampling results.

Another example of negative wording that should be avoided in the stem is "All of the following are true, **except** . . ." Writers are often tempted to write "except" questions because testing exceptions is often easier than testing general rules and occurrences. Unless the examination goal is to test knowledge of exceptions, avoid this format.

Also, *never use double negatives*—negatives in both the stem and at least one of the distractors. Double negatives are very confusing to candidates who must sort out what is really being asked, which generally reduces the item's validity for measuring the target knowledge or skill.

Response Option Construction Guidelines

15. **Make sure that there is only one "correct" or "best" option.** At first glance, this seems like it should be obvious, but there are situations when it's not clear whether one of the intended distractors is correct or incorrect. This is exemplified in the sample question for guideline 11. It can also happen when options overlap. The following is an example of a question with two correct answers and overlapping distractors.

Example:

POOR

Which of the following statements is correct regarding an S corporation?

- A. It may issue both common and preferred stock.
- B. It may have 25 shareholders.
- C. It may issue two classes of stock.
- D. It may have as many as 35 shareholders.*

This question actually has two correct answers because the keyed response, D, subsumes B. That is, both D and B are correct because an S corporation may have any number of shareholders up to 35, including 25.

In this example, distractors A and C also overlap. If a candidate knows that A is incorrect, option C may be eliminated as well.

IMPROVED

Which of the following statements is correct regarding an S corporation?

- A. It may have both common and preferred stock.
- B. It may have a corporation as a shareholder.
- C. It may be a member of an affiliated group.
- D. It may have as many as 35 shareholders.*

16. **Place response options in logical or numerical order, when appropriate; otherwise, order them randomly.** Numerical options should be put either in ascending or descending order.

Example:

POOR

In 1995, Jones, who is single, gave an outright gift of \$50,000 to a friend, Gould, who needed the money to pay medical expenses. In filing the 1995 gift tax return, Jones was entitled to a maximum exclusion of

- A. \$20,000
- B. \$10,000*
- C. \$40,000
- D. \$ 3,000

To make it easier for a candidate who knows the correct answer to find it, the options should be ordered in one of the following ways:

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- A. \$40,000
- B. \$20,000
- C. \$10,000*
- D. \$ 3,000

or

- A. \$ 3,000
- B. \$10,000*
- C. \$20,000
- D. \$40,000

When there is no logical order in which to place options, they should be ordered randomly to make it less likely that a candidate will be able to guess successfully by choosing a preferred response position.

17. **Keep option length consistent.** It is easy to make the correct answer longer than the distractors because the correct option may require more complete information than the distractors; however, when one option is longer than the others, it may provide a cue to candidates that it is the correct answer.

Example:

POOR

Under the lower of cost or market method, the replacement cost of an inventory item would be used as the designated market value

- A. When it is below the net realizable value less the normal profit margin.
- B. When it is below the net realizable value and above the net realizable value less the normal profit margin.*
- C. When it is above the net realizable value.
- D. Regardless of net realizable value.

In this example, the correct answer, B, is much longer and more complete than the other options. Candidates who do not know the answer may guess that B is correct. The flaw in this item may be corrected by lengthening one or more of the distractors, shortening the correct option, or putting all relevant information in the stem. Distractors, and even the key, may be changed. The key may be changed only if the revised item still assesses the original objective.

IMPROVED

Under the lower of cost or market method, the replacement cost of an inventory item was below the original cost, below the net realizable value, and above the net realizable value less the normal profit margin. What should be used as the designated market value?

- A. Net realizable value.
- B. Net realizable value less the normal profit margin.
- C. Replacement cost.*
- D. Original cost.

In this example, the stem has been lengthened to include information originally contained in the responses, all options have been shortened, and the key response has been changed.

18. **Keep all options in a question homogeneous in content.** Do not include options that are unrelated to other options.

Example:

POOR

According to the FASB Conceptual Framework, earnings

- A. Are the same as income from continuing operations.
- B. Exclude certain gains and losses that are included in comprehensive income.*
- C. Include certain gains that are excluded from comprehensive income.
- D. Are the same as comprehensive income.

In this example, option A is the only option that does not mention comprehensive income. This usually happens when a good fourth option is hard to write, and it cues candidates who do not know the answer to eliminate that incorrect option.

IMPROVED

According to the FASB Conceptual Framework, how do earnings differ from comprehensive income?

- A. Include certain losses that are excluded from comprehensive income.
- B. Exclude certain gains and losses that are included in comprehensive income.*
- C. Include certain gains and losses that are excluded from comprehensive income.
- D. Do not differ.

This example also shows how using the question format instead of the completion format in the stem makes the question's objective clearer.

19. **Avoid specific determiners, such as *all*, *none*, *always*, and *never*.** Examinees who have good test taking skills tend to eliminate options with specific determiners if they do not know the correct answer because options with specific determiners are more likely to be distractors than are options with qualifiers like *generally* and *usually*.

Example:

POOR

In a statement of support, revenue, and expenses and changes in fund balances of a voluntary health and welfare organization, contributions to the building fund should

- A. Generally be included as an element of support.*
- B. Always be included as an element of revenue.
- C. Always be included as an element of other changes in fund balances.
- D. Never be included.

In this example, sophisticated test takers who do not know the answer probably would eliminate B, C, and D because these options imply absolutes, which are less likely to be always true than options with qualifiers, such as *often*, *mostly*, and *sometimes*. Avoiding specific determiners in distractors when the correct answer is qualified makes guessing more difficult.

IMPROVED

In a statement of support, revenue, and expenses and changes in fund balances of a voluntary health and welfare organization, contributions to the building fund should

- A. Be included as an element of support.*
- B. Be included as an element of revenue.
- C. Be included as an element of other changes in fund balances.
- D. Not be included.

However, when the examination objective is to test an absolute, try to phrase all options in absolute terms.

20. **Avoid using *all of the above* or *none of the above* as options except in Roman-type and columnar-type questions.** While research results on this issue are mixed, there is evidence that using *all of the above* makes items less discriminating. This is probably because a candidate who recognizes that two options are correct also recognizes that *all of the above* must be the intended answer. Though there may be situations when *none of the above* is appropriate—for example, when the objective of the item is to assess knowledge of what is false—these are rarely assessed on the Uniform CPA Examination.

Distractor Construction Guidelines

21. **Use plausible distractors.** Distractors that can be eliminated by all candidates because they do not make sense, and those that can be eliminated by unknowledgeable candidates who can recognize a response as obviously incorrect, serve no purpose and cause the question to be less discriminating and less difficult.

Example:

POOR

The financial statement that summarizes a company's financial position is the

- A. Income statement.
- B. Balance sheet.*
- C. Statement of cash flows.
- D. Organizational chart.

In this example, option D is not plausible because it is not a financial statement and can be eliminated easily by an unknowledgeable candidate. This effectively turns the item into a three-option multiple-choice item, making correct guessing easier. The item would be improved if option D were changed to read:

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- D. Statement of retained earnings.

22. **Incorporate common candidate errors in distractors whenever possible.** These can be gleaned from previous examination questions, both objective and essay, as well as from authoritative sources and textbooks.

23. **Avoid humorous options.** While humor may make some candidates feel more at ease, it may distract others or make them feel anxious. If you cannot avoid being funny when you draft an item, make sure you edit the humor out before submitting it.

Other Objective Answer Formats

As noted in Chapter 2, multiple-choice questions are beneficial because they can be used to test a variety of content, and they can be scored efficiently. Other types of question formats, which we call other objective answer formats (OOAFs), retain these same advantages, but differ in appearance from the traditional multiple-choice format. These formats are used when they are more efficient than multiple-choice questions for testing knowledge and skills, or when they can better assess specific knowledge and skills.

Any objectively-scored question that is different in appearance from the multiple-choice format can be considered an OOAF. Therefore, within the constraints set by the examination specifications, OOAFs are limited only by the creativity and imaginations of the item writers and the preparation subcommittees and by the requirement that they measure the target knowledge and skills. Some of the more conventional types of OOAFs are the constructed-response format, the matching format, the graphic format, and the multiple yes/no format. These four OOAF types are described following the discussion of general guidelines for writing OOAFs.

GUIDELINES FOR WRITING OOAFs

Because OOAFs may be less familiar than multiple-choice questions to CPA candidates, it is important to provide candidates with clear instructions for recording their answers. The following guidelines are recommended for presenting general instructions, fact patterns, question requirements, and examples. Adherence to these guidelines will reduce the amount of time necessary for candidates to answer the questions and will help to minimize errors they may make in recording their responses.

1. **General Instructions.** The general instructions specify how many responses are required in the OOAF and the general manner in which the answer sheet should be marked. The instructions should immediately precede the relevant information (text, table, graphic, etc.). This will help to focus candidates' attention on how they should respond to the questions. The instructions should clearly specify the corresponding response numbers and should be as clear and concise as possible, containing all the information candidates need to record their responses. Keeping the instructions short minimizes the chances that candidates will be confused about how to record their answers, and reduces reading time. However, all relevant information should be included in the general instructions. Finally, the instructions should specify where the responses

are to be recorded and the format in which they are to be recorded. See the examples following the description of each OOAF format.

2. **Fact Pattern.** The fact pattern should contain all information relevant to answering the questions and still be clear and concise. Depending on the type of OOAF and the target knowledge and skills, the fact pattern may be as short as a sentence or two, or it may be several paragraphs long.
3. **Question Requirements.** The “required” lays out specifically what candidates need to do to respond to the items to get credit for their answers. Because OOAFs are by their nature quite varied, the “required” should be clear and precise. Typically, the requirements begin by identifying the items to which they are pertinent, for example, “**Required: For Items 61 through 69...**” Occasionally, when the fact pattern is very short, it may be clearer to candidates if “General Instructions” and “Question Requirements” are combined into a single paragraph. Detailed examples of “requireds” are included under the description of each particular OOAF format.
4. **All headings above the lists of response options in the question booklet should also be included on the answer sheet.**
5. **Print the keywords of the instructions in boldface type.** Allow the directions to stand out so that the candidates realize that they are important.
6. **Ensure that the directions are relevant for all the items included in the item set.**
7. **Limit the length of the question (including directions, relevant information, and items) to two facing pages.** This will keep candidates from having to turn back and forth within the test booklet to complete the answers..
8. **Try to use numbers that can be rounded to two or three significant digits.** Otherwise, the amount of time required to respond increases to the point where the numeric format is inefficient. Note in the example on page 35 that following zeros were preprinted on the answer sheet to save candidate time.
9. **In a matching question, as many of the response options as possible should be plausible alternatives for each item.** However many response options there are in a matching question, if each item has only one or two that are plausible to *unknowledgeable* candidates, many such candidates will guess correctly. A good rule of thumb is to aim to have at least three plausible incorrect response options for each item. This would make correct guessing by candidates at least as difficult as it would be if the item were a well-written multiple-choice question.
10. **Response options should be ordered or grouped in meaningful ways.** The list of response options should be ordered logically and, if reasonable, segmented into groups. For example, in a taxation question all deductions should be grouped together, ordered by how they appear on the tax forms.

11. **The general directions for matching questions should state that each response option “. . . may be selected once, more than once, or not at all.”** Unlike some matching formats for which each response option (right-hand column) matches to only one item (left-hand column), those used on the Uniform CPA Examination are not bound by that constraint. This means that candidates cannot assume that they can eliminate responses that have already been used. The instructions should make this point clear. Telling candidates about this in the instructions makes these “ground rules” obvious.
12. **Each item in a graphic question should require the use of the graphic to answer the question.** It is an inefficient use of complex graphic formats if all related items do not require interpretation of the information in the graphic. The most common violation of this guideline is the use of general questions that could be answered without reference to the fact pattern or graphic.
13. **The graphic should be comparable to those that CPAs would be expected to use or interpret.** The form of the graphic should reflect the types of graphics CPAs encounter in practice. Graphics that are too complex may require interpretation skills beyond those needed by new CPAs; innovative or unusual graphic forms should be used cautiously to avoid the same outcome.
14. **The graphic should be clearly reproducible and easy to read.** Although this sounds obvious, graphic images generally have more detail than text. Limitations on page size could result in reducing the size of the graphic image below that needed for some candidates to interpret the information contained. Generally, the simpler the graphic, the smaller the impact of reducing the image. As the amount of detail increases, reducing the image becomes more problematic. The flowchart example on page 40, reduced to use space efficiently in the Guide, shows how a detailed graphic can be difficult to use if it is too small.
15. **Each of the options must be clearly correct or incorrect.** The “best answer” format is not appropriate for multiple yes-no items. The correct answer for each choice should be unequivocal.
16. **The overall difficulty of each multiple yes-no response option should be comparable to that of multiple-choice questions.** One of the most difficult problems with writing multiple yes-no questions is in gauging the difficulty of each statement. Typically, some items are very easy because the answers are obvious. This is most often true of “no” answers.

Constructed-response formats (numeric formats)

The constructed-response format requires candidates to provide the correct answer to a question rather than to select the correct answer from a group of response alternatives. In this sense, these formats are similar to the essay/problem formats; however, the answers can be scored objectively by machine. Thus, the constructed-response format has some of the desirable qualities of both the multiple-choice item format (they can be scored by machine) and the free-response format (the candidate must generate, not select, the answer).

The constructed-response format typically used on the Uniform CPA Examination requires candidates to provide numeric answers to computational problems. These constructed-response formats are sometimes termed *numeric formats*. Candidates are required to answer each question by writing numbers and blackening corresponding ovals on an optical scan sheet.

Example:

General Instructions

This question consists of 4 items. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Answer all items.** Your grade will be based on the total number of correct answers.

Fact Pattern

Ulla, Inc. is a medical laboratory that performs tests for physicians. Ulla anticipates performing between 5,000 and 12,000 tests during the month of April. Relevant information is as follows:

At the low range of activity (0 to 4,999 tests performed):

Sales price per test	\$ 60
Variable costs per test	20
Fixed costs	160,000

At the high range of activity (5,000 to 14,999 tests performed):

Sales price per test	\$ 60
Variable costs per test	20
Fixed costs	200,000

Compared to industry averages, at the low range of activity Ulla has a lower sales price per test, higher fixed costs, and the same breakeven point in number of tests performed. At the high range of activity, Ulla's sales price per test and fixed costs are the same as industry averages, and Ulla's variable costs are lower.

Question Requirements

Items 1 through 4 require numeric responses. For all items, calculate the amounts requested. To record your answer, blacken the ovals on the *Objective Answer Sheet*. If zeros precede your numerical answer, blacken the zeros in the ovals preceding your answer. **You cannot receive credit for your answers if you fail to blacken an oval in each column.** You may write the numbers in the boxes provided to facilitate blackening the ovals; however, the numbers written in the boxes will not be graded.

Items to be Answered:

1. Contribution margin per test.
2. Breakeven point in number of tests at low activity range.
3. Breakeven point in number of tests at high activity range.
4. Number of units sold to achieve a gross profit of \$160,000.

1

0	4	0
●	○	●
1	1	1
2	2	2
3	3	3
4	●	4
5	5	5
6	6	6
7	7	7
8	8	8
9	9	9

Zeros have already been preprinted for the ones, tens, and hundreds columns. If zeros precede your numerical answer, blacken the zeros in the ovals preceding your answer. You may write the numbers in the boxes provided to facilitate blackening the ovals; however, the numbers written in the boxes will **not** be graded.

2

0	0	4	,	0	0	0
●	●	○	,	●	●	●
1	1	1	,			
2	2	2	,			
3	3	3	,			
4	4	●	,			
5	5	5	,			
6	6	6	,			
7	7	7	,			
8	8	8	,			
9	9	9	,			

3

0	0	5	,	0	0	0
●	●	○	,	●	●	●
1	1	1	,			
2	2	2	,			
3	3	3	,			
4	4	4	,			
5	5	●	,			
6	6	6	,			
7	7	7	,			
8	8	8	,			
9	9	9	,			

4

0	0	9	,	0	0	0
●	●	○	,	●	●	●
1	1	1	,			
2	2	2	,			
3	3	3	,			
4	4	4	,			
5	5	5	,			
6	6	6	,			
7	7	7	,			
8	8	8	,			
9	9	●	,			

Matching formats

A second type of OAAF, the matching format, presents candidates with two sets of information that must be related in a meaningful way. The most common type of matching format is a two-column format: candidates are asked to select from the options in the right-hand column the one that corresponds to, or is associated with, a term or statement in the left-hand column. Each element in the left-hand column represents a separate item, with a distinct number, to be answered.

Matching formats are particularly useful in assessing two types of objectives. First, matching formats can be an efficient substitute for several multiple-choice items that have the same response options. Second, matching formats can be used to assess integrative knowledge when all possible reasonable actions or conditions can be accounted for in the list of response options.

Matching formats are especially useful for assessing candidates' ability to differentiate among related conditions or concepts. An example of a matching format follows.

Example:

This question consists of 25 items. Select the **best** answer for each item. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Answer all items.** Your grade will be based on the total number of correct answers.

Gray is self-employed as an organizational development consultant and reports on the cash basis for income tax purposes. Listed below are Gray's 1995 business and non-business transactions, as well as possible tax treatments.

Required:

For each of Gray's transactions (Items 1-25), select the appropriate tax treatment and blacken the corresponding oval on the *Objective Answer Sheet*. A tax treatment may be selected once, more than once, or not at all.

<u>Transactions</u>	<u>Tax Treatments</u>
1. Retainer fees received from clients.	<input type="radio"/> Ⓐ Taxable as other income on Form 1040.
2. Oil royalties received.	<input type="radio"/> Ⓑ Reported in Schedule B—Interest and Dividend Income.
3. Interest income on general obligation state and local government bonds.	<input type="radio"/> Ⓒ Reported in Schedule C—Profit or Loss from Business as trade or business income.
4. Interest on refund of federal taxes.	<input type="radio"/> Ⓓ Reported in Schedule E—Supplemental Income and Loss.
5. Death benefits from term life insurance policy on parent.	<input type="radio"/> Ⓔ Not taxable.
6. Interest income on U.S. Treasury bonds.	<input type="radio"/> Ⓕ Fully deductible on Form 1040 to arrive at adjusted gross income.
7. Share of ordinary income from an investment in a limited partnership reported in Form 1065, Schedule K-1.	<input type="radio"/> Ⓖ Fifty percent deductible on Form 1040 to arrive at adjusted gross income.
8. Taxable income from rental of a townhouse owned by Gray.	<input type="radio"/> Ⓗ Reported in Schedule A—Itemized Deductions (deductibility subject to threshold of 7.5% of adjusted gross income).
9. Prize won as a contestant on a TV quiz show.	<input type="radio"/> Ⓘ Reported in Schedule A—Itemized Deductions (deductibility subject to threshold of 2% of adjusted gross income).
10. Payment received for jury service.	<input type="radio"/> Ⓢ Reported in Form 4562—Depreciation and Amortization, and deductible in Schedule A—Itemized Deductions (deductibility subject to threshold of 2% of adjusted gross income).
11. Dividends received from mutual funds that invest in tax-free government obligations.	<input type="radio"/> Ⓚ Reported in Form 4562—Depreciation and Amortization, and deductible in Schedule C—Profit or Loss from Business.
12. Qualifying medical expenses not reimbursed by insurance.	<input type="radio"/> Ⓛ Fully deductible in Schedule C—Profit or Loss from Business.
13. Personal life insurance premiums paid by Gray.	<input type="radio"/> Ⓜ Partially deductible in Schedule C—Profit or Loss from Business.
14. Expenses for business-related meals where clients were present.	<input type="radio"/> Ⓝ Reported in Form 2119—Sale of Your Home, and deductible in Schedule D—Capital Gains and Losses.
15. Depreciation on personal computer purchased in 1995 and used for business.	<input type="radio"/> Ⓞ Not deductible.
16. Business lodging expenses, while out of town.	
17. Subscriptions to professional journals used for business.	
18. Self-employment taxes paid.	
19. Qualifying contributions to a simplified employee pension plan.	
20. Election to expense business equipment purchased in 1995.	
21. Qualifying alimony payments made by Gray.	
22. Subscriptions for investment-related publications.	
23. Interest expense on a home-equity line of credit for an amount borrowed to finance Gray's business.	
24. Interest expense on a loan for an auto used 75% for business.	
25. Loss on sale of residence.	

(10 points)

ANSWER	Item	Tax Treatments (select one)														
	1	<input type="radio"/> A	<input type="radio"/> B	<input checked="" type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	2	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input checked="" type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	3	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input checked="" type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	4	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	5	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input checked="" type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	6	<input type="radio"/> A	<input checked="" type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	7	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input checked="" type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	8	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input checked="" type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	9	<input checked="" type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	10	<input checked="" type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	11	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input checked="" type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	12	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input checked="" type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	13	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input checked="" type="radio"/> O
	14	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input checked="" type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	15	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input checked="" type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	16	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input checked="" type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	17	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input checked="" type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	18	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input checked="" type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	19	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input checked="" type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	20	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input checked="" type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	21	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input checked="" type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	22	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input checked="" type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	23	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input checked="" type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
	24	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input checked="" type="radio"/> M	<input type="radio"/> N	<input type="radio"/> O
25	<input type="radio"/> A	<input type="radio"/> B	<input type="radio"/> C	<input type="radio"/> D	<input type="radio"/> E	<input type="radio"/> F	<input type="radio"/> G	<input type="radio"/> H	<input type="radio"/> I	<input type="radio"/> J	<input type="radio"/> K	<input type="radio"/> L	<input type="radio"/> M	<input type="radio"/> N	<input checked="" type="radio"/> O	

In this example, the number of tax treatments in the right-hand column is large enough to make successful random guessing insignificant. Note that the tax treatments are listed in a logical order: A–E refer to where taxable income should be reported, and F–O refer to an item’s deductibility. Within these two groupings, the order of the treatments is also logical. In a matching item with many response options, this ordering is critical to ensure that skills peculiar to the format have a minimal impact on candidates’ ability to show the target knowledge and skills. For example, unless one purpose of the matching format was to assess visual tracking and short-term memory, randomly ordering the options would give candidates with high levels of these skills an unfair advantage.

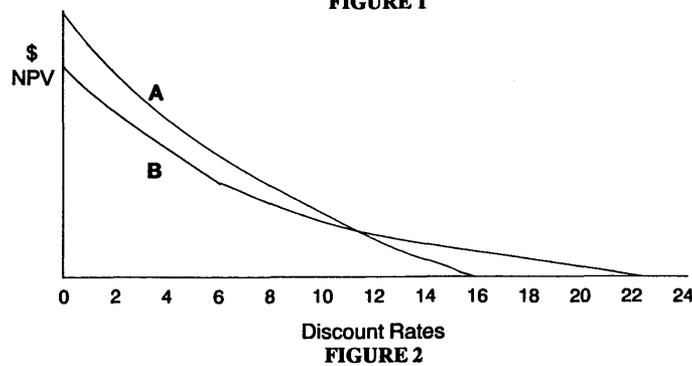
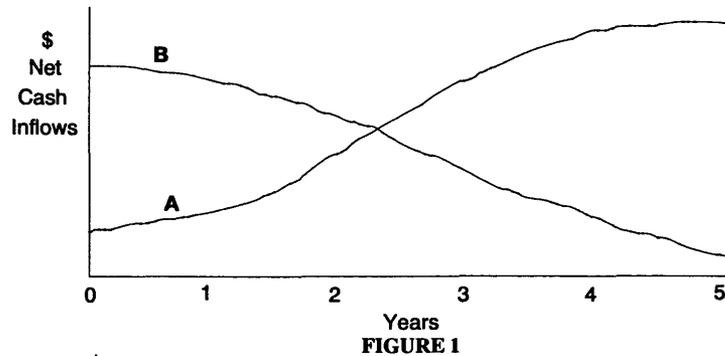
Graphic questions

A third type of OOAF uses graphic presentations. Graphic questions assess candidates’ skill in working with accounting and auditing information in symbolic ways. Graphic formats are often used because they integrate and summarize information efficiently. Some graphic questions require candidates to show they can extract relevant information and make appropriate judgments, and others require candidates to recognize parts of a system.

Example 1:

Items 1 through 4 are based on the following:

A company has two mutually exclusive projects, A and B, which have the same initial investment requirements and lives. Project B has a decrease in estimated net cash inflows each year, and project A has an increase in estimated net cash inflows each year. Project A has a greater total net cash inflow. Figure 1 shows the net cash inflows of each project by year. Figure 2 shows the net present value (NPV) of each project assuming various discount rates.



Required:

For **Items 1 through 4**, select your answer from the following list and blacken the corresponding oval on the *Objective Answer Sheet*.

- (A) Project A.
- (B) Project B.
- (C) Both projects equal.

1. Which project would be likely to have the shorter payback period?
2. Which project would have the greater average accounting rate of return?
3. Which project would have the greater internal rate of return?

4. Assume, due to innovation, the projects were to terminate at the end of year 4 with cash flows remaining as projected for the first 4 years and no cash flows in year 5. Which project would have the greater internal rate of return?

Example 2:

Instructions

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

Required:

The flowchart following the answer lists depicts part of a client's revenue cycle. Some of the flowchart symbols are labeled to indicate control procedures and records. For each symbol numbered 61 through 73, select one response from the answer lists below and blacken the corresponding oval on the *Objective Answer Sheet*. Each response in the lists may be selected once, more than once, or not at all.

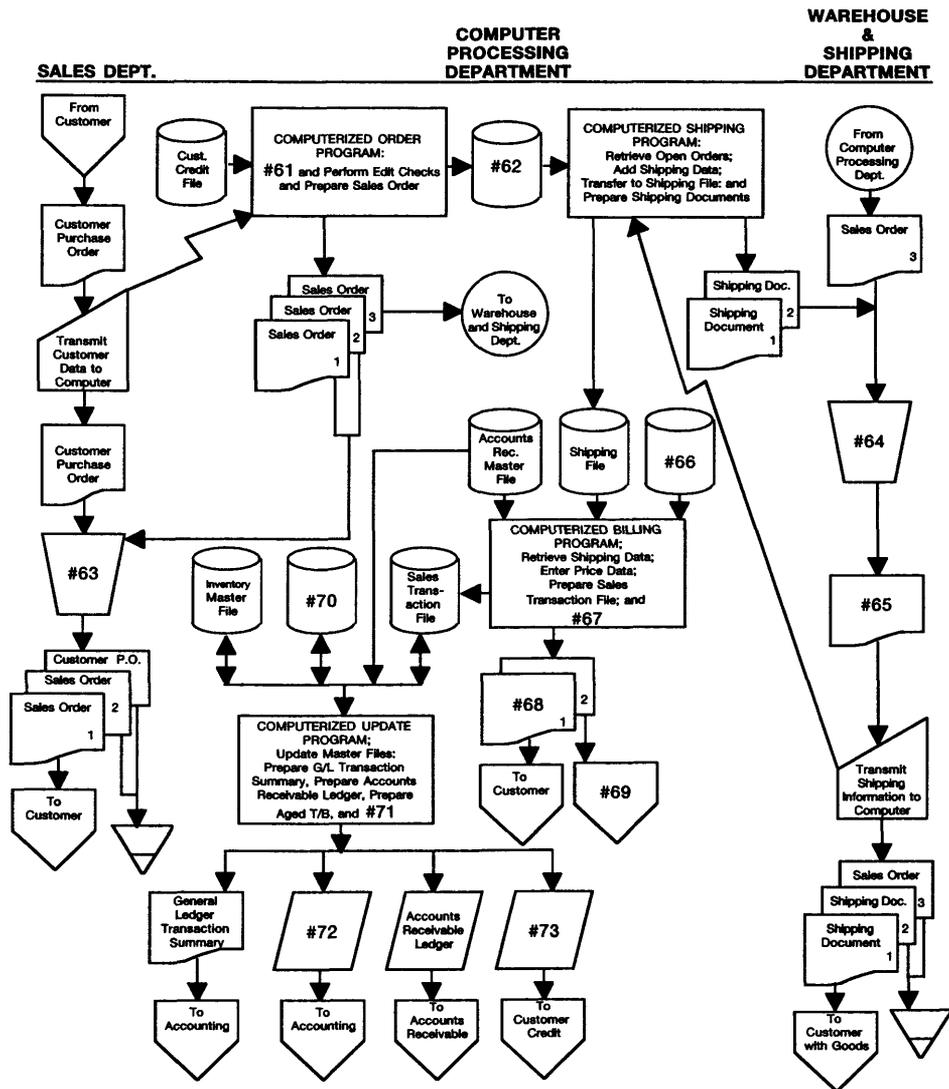
Answer Lists

Operations and Control Procedures

- (A) Enter shipping data.
- (B) Verify agreement of sales order and shipping document.
- (C) Write off accounts receivable.
- (D) To warehouse and shipping department.
- (E) Authorize account receivable write-off.
- (F) Prepare aged trial balance.
- (G) To sales department.
- (H) Release goods for shipment.
- (I) To accounts receivable department.
- (J) Enter price data.
- (K) Determine that customer exists.
- (L) Match customer purchase order with sales order.
- (M) Perform customer credit check.
- (N) Prepare sales journal.
- (O) Prepare sales invoice.

Documents, Journals, Ledgers, and Files

- (P) Shipping document.
- (Q) General ledger master file.
- (R) General journal.
- (S) Master price file.
- (T) Sales journal.
- (U) Sales invoice.
- (V) Cash receipts journal.
- (W) Uncollectible accounts file.
- (X) Shipping file.
- (Y) Aged trial balance.
- (Z) Open order file.



Multiple yes-no formats

The multiple yes-no format consists of a stem followed by a number of statements or options. The candidate must indicate whether each option fulfills the stated requirements. Multiple yes-no formats are useful for testing candidates' knowledge of related concepts. An example of this type of question follows.

Example:

Required:

For **Items 1 through 4**, what information should a successor auditor obtain when making inquiries of the predecessor auditor before accepting an engagement?

1. Facts that bear on management's integrity.
2. Disagreements with management concerning auditing procedures.
3. Whether statistical or nonstatistical sampling was used to gather evidence.
4. The effect of the client's internal audit function on the scope of the independent auditor's examination.

Answers:

- | | | |
|----|----------------------------------|----------------------------------|
| | Y | N |
| 1. | <input checked="" type="radio"/> | <input type="radio"/> |
| 2. | <input checked="" type="radio"/> | <input type="radio"/> |
| 3. | <input type="radio"/> | <input checked="" type="radio"/> |
| 4. | <input type="radio"/> | <input checked="" type="radio"/> |

A Note on Writing Multiple Yes-No Questions

Because multiple yes-no questions require candidates to respond to each option, special care must be taken in their construction. It is important to state the directions for answering these questions clearly and unambiguously.

The experience to date of the AICPA Examinations Division with multiple yes-no formats is, on average, they are substantially easier than multiple-choice questions and add little to the Examination's reliability. For these reasons the use of multiple yes-no items should be used judiciously until further evaluation suggests better ways to use them effectively.

Essay Questions and Problems

In addition to using objective formats, the Uniform CPA Examination tests candidates' knowledge and skills using constructed response formats other than the numeric OOAFs discussed in Chapter 4. Essay questions and problems are used to assess candidates' cognitive skills for applying and evaluating knowledge that falls within the scope of the Uniform CPA Examination. An essay requires candidates to formulate an answer in writing, while a problem-type question requires candidates to make calculations and express answers primarily in numeric form. These formats present frameworks that require candidates to organize and integrate information and recommend courses of action. Like OOAFs, each essay and problem contains instructions, a fact pattern, and requirements. In addition, an "ideal answer" should be written as a key for use in subsequent grading to illustrate a solution that would get full credit. A suggested grading guide, which indicates the various components of the answer that should receive credit and their point values, should be included as part of the key.

Example:

Green, CPA, is auditing Rayne Co.'s 1995 financial statements. The controller, Dunn, has provided Green with the following information:

- At December 31, 1994, Rayne had a note payable to Federal Bank with a balance of \$90,000. The annual principal payment of \$10,000, plus 8% interest on the unpaid balance, was paid when due on March 31, 1995.
- On January 2, 1995, Rayne leased two automobiles for executive use under a capital lease. Five annual lease payments of \$15,000 are due beginning January 3, 1995. Rayne's incremental borrowing rate on the date of the lease was 11% and the lessor's implicit rate, which was known by Rayne, was 10%. The lease was properly recorded at \$62,500 before the first payment was made.
- On July 1, 1995, Rayne received proceeds of \$538,000 from a \$500,000 bond issuance. The bonds mature in 15 years and interest of 11% is payable semiannually on June 30 and December 31. The bonds were issued at a price to yield investors 10%. Rayne uses the effective interest method to amortize bond premiums.

- For the year ended December 31, 1995, Rayne has adopted Financial Accounting Standards Board Statement No. 109, *Accounting for Income Taxes*. Dunn has prepared a schedule of all differences between financial statement and income tax return income. Dunn believes that as a result of pending legislation, the enacted tax rate at December 31, 1995, will be increased for 1996. Dunn is uncertain which differences to include and which rates to apply in computing deferred taxes under Statement No. 109. Dunn has requested an overview of Statement No. 109 from Green.

Required:

- Prepare a schedule of interest expense for the year ended December 31, 1995.
- Prepare a brief memo to Dunn from Green:
 - identifying the objectives of accounting for income taxes,
 - defining temporary differences,
 - explaining how to measure deferred tax assets and liabilities, and
 - explaining how to measure deferred income tax expense or benefit.

Answer:

a.

Rayne Co.
SCHEDULE OF INTEREST EXPENSE
For the Year Ended December 31, 1995

Note payable	\$ 6,600	[1]
Capital lease obligation	4,750	[2]
Bonds payable	<u>26,900</u>	[3]
Total interest expense	<u>\$38,250</u>	

[1] $1,800 (90,000 \times 8\% \times \frac{3}{12}) + 4,800 (80,000 \times 8\% \times \frac{9}{12})$

[2] $10\% \times 47,500 (62,500 - 15,000)$

[3] $538,000 \times 10\% \times \frac{1}{2}$

- To: Dunn
 From: Green
 Re: Accounting for income taxes

Below is a brief overview of accounting for income taxes in accordance with FASB Statement No. 109.

The objectives of accounting for income taxes are to recognize (a) the amount of taxes payable or refundable for the current year, and (b) deferred tax liabilities and assets for the estimated future tax consequences of temporary differences and carryforwards. Temporary

differences are differences between the tax basis of assets or liabilities and their reported amounts in the financial statements that will result in taxable or deductible amounts in future years.

Deferred tax assets and liabilities are measured based on the provisions of enacted tax law; the effects of future changes in the tax laws or rates are not anticipated. The measurement of deferred tax assets is reduced, if necessary, by a valuation allowance to reflect the net asset amount that is more likely than not to be realized. Deferred income tax expense or benefit is measured as the change during the year in an enterprise's deferred tax liabilities and assets.

This essay question has two separate requirements. The first requires candidates to prepare a schedule based on information contained in the fact pattern. The second requires candidates to write a memo to the controller of a company. To meet these requirements, candidates need to understand the information presented, analyze it, reorganize it, apply it in a business context, and then communicate it in writing. This particular question demands that candidates apply a wide range of cognitive skills. Requirement **b** is specifically targeted to assess candidates' ability to write a letter in a style suitable for a particular reader.

In this essay question, all relevant information for preparing the statement is included in the fact pattern, and the requirements are clear, concise, and specific to the target knowledge and skills. Most candidates will know exactly what task the essay requirements set out for them.

Two problems eclipse all others in writing essay questions, probably because question writers know what they are trying to assess and often do not see that the questions will not elicit the answers they anticipate. The first problem is the failure to write requirements that are specific enough to elicit the knowledge and skills targeted by the writer. For instance, in the example, one target is the "knowledge of the objectives of accounting for income taxes," and another is "skill in communicating accounting information to someone familiar with such information (a controller)." Requirement **b** is specific in eliciting the knowledge and skills targeted. Note, however, the alternative wording:

b. Prepare a brief memo from Dunn to Green about the audit.

This requirement is concise and clear, but it is far from specific. It is likely to elicit a wide variety of knowledge and skills, many of which respond to the requirement as worded, but not to what the writer intended to assess.

The second problem is writing a sample answer that accurately reflects what is specified in the essay requirements. For example, candidates reading the requirement:

- define temporary differences

should be expected to define temporary differences and not to write about specific characteristics of temporary differences or their implications. An inexperienced item writer might develop the sample answer incorporating other knowledge or skills into the grading. In this case, the writer intended the requirement to be more focused than the sample answer would suggest. Conversely, the sample answer may accurately represent the target knowledge and skills, but the requirement is flawed. In either case, the meaningfulness of the grading is marred by the lack of correspondence between the essay item and the sample answer.

Example:

North, CPA, is an independent auditor planning an audit of the financial statements of General Co. In determining the nature, timing, and extent of the auditing procedures, North is considering General's internal audit function, which is staffed by Tyler.

Required:

- a. In what ways may Tyler's work be relevant to North?
- b. What factors should North consider and what inquiries should North make in deciding whether to use Tyler's work?

Answer:

a. Tyler's work may be relevant to North in several ways. First, it may help North to obtain a sufficient understanding of the design of General's internal control structure policies and procedures. Second, it would help North determine whether the policies and procedures have been placed in operation. Third, Tyler's work could help North assess risk. Since an objective of most internal audit functions is to review, assess, and monitor internal control policies and procedures, the internal audit procedures performed by Tyler may provide useful information to North.

Tyler's work may also provide direct evidence about material misstatements in assertions about specific account balances or classes of transactions. Therefore, Tyler's work may help North to plan substantive procedures. Consequently, North may be able to change the nature, timing, or extent of certain procedures.

North may request direct assistance from Tyler. This direct assistance relates to work North specifically requests Tyler to perform to complete some aspect of North's work.

b. If North concludes that Tyler's work is relevant to North's audit of General's financial statements, North should consider whether it would be efficient to consider how Tyler's work might affect the nature, timing, and extent of North's audit procedures. If so, North should assess Tyler's competence and objectivity in light of the intended effect of Tyler's work on North's audit.

North ordinarily should inquire about Tyler's organizational status within General and about Tyler's application of the professional internal auditing standards developed by the Institute of Internal Auditors and the General Accounting Office. North also should inquire about Tyler's internal audit plan, including the nature, timing, and extent of the audit work performed. Additionally, North should inquire about Tyler's access to General's records and whether there are any limitations on the scope of Tyler's activities.

Compared with the first example, this essay makes less use of information in the fact pattern and relies more on the knowledge that candidates are expected to bring with them to the Examination. It is designed to assess candidates' in-depth knowledge of an internal auditor's work, how it may be used by the independent auditor, and when the independent auditor may rely on it. A candidate can write a complete, detailed response that can be evaluated for writing skills for both requirements of the question.

Example:

Suburban Properties, Inc. owns and manages several shopping centers.

On May 4, Suburban received from Bridge Hardware, Inc., one of its tenants, a signed letter proposing that the existing lease between Suburban and Bridge be modified to provide that certain utility costs be equally shared by Bridge and Suburban, effective June 1. Under the terms of the original lease, Bridge was obligated to pay all utility costs. On May 5, Suburban sent Bridge a signed letter agreeing to share the utility costs as proposed. Suburban later changed its opinion and refused to share in the utility costs.

On June 4, Suburban received from Dart Associates, Inc. a signed offer to purchase one of the shopping centers owned by Suburban. The offer provided as follows: a price of \$9,250,000; it would not be withdrawn before July 1; and an acceptance must be received by Dart to be effective. On June 9, Suburban mailed Dart a signed acceptance. On June 10, before Dart had received Suburban's acceptance, Dart telephoned Suburban and withdrew its offer. Suburban's acceptance was received by Dart on June 12.

On June 22, one of Suburban's shopping centers was damaged by a fire, which started when the center was struck by lightning. As a result of the fire, one of the tenants in the shopping center, World Popcorn Corp., was forced to close its business and will be unable to reopen until the damage is repaired. World sued Suburban, claiming that Suburban is liable for World's losses resulting from the fire. The lease between Suburban and World is silent in this regard.

Suburban has taken the following positions:

- Suburban's May 5 agreement to share equally the utility costs with Bridge is not binding on Suburban.
- Dart could not properly revoke its June 4 offer and must purchase the shopping center.
- Suburban is not liable to World for World's losses resulting from the fire.

Required:

In separate paragraphs, determine whether Suburban's positions are correct and state the reasons for your conclusions.

Answer:

Suburban is correct concerning the agreement to share utility costs with Bridge. A modification of a contract requires consideration to be binding on the parties. Suburban is not bound by the lease modification because Suburban did not receive any consideration in exchange for its agreement to share the cost of utilities with Bridge.

Suburban is not correct with regard to the Dart offer. An offer can be revoked at any time prior to acceptance. This is true despite the fact that the offer provides that it will not be withdrawn prior to a stated time. If no consideration is given in exchange for this promise not to withdraw the offer, the promise is not binding on the offeror. The offer provided that Suburban's acceptance would not be effective until received. Dart's June 10 revocation terminated Dart's offer. Thus, Suburban's June 9 acceptance was not effective.

Suburban is correct with regard to World's claim. The general rule is that destruction of, or damage to, the subject matter of a contract without the fault of either party terminates the contract. In this case, Suburban is not liable to World because Suburban is discharged from its contractual duties as a result of the fire, which made performance by it under the lease objectively impossible.

On first glance, the requirement in this example seems less elaborate than the preceding example. However, it is clear and specific, referring to legal positions described at the end of the fact pattern. This example requires candidates to show their understanding of business law involving contract offers, acceptances, consideration, and termination, and to explain how this law applies in specific instances. A good answer to this essay demands that candidates be able to integrate their business law knowledge with their understanding of the specific facts presented in the fact pattern, to take positions, and to defend those positions persuasively using their knowledge and the facts presented.

ADDITIONAL GUIDELINES FOR WRITING ESSAY QUESTIONS AND PROBLEMS

1. **Make sure the question elicits the target knowledge and skills.** One difficulty in writing a good essay question is ensuring that it elicits the target knowledge and skills on which the candidate is intended to be assessed. The best way to ensure that it does is to compare the fact pattern and requirements to the *ideal* answer. When drafting an essay question, changing the focus back and forth from the fact pattern and requirements to the ideal answer is a good way to ensure the knowledge and skills expected in the answer will be, in fact, elicited from knowledgeable candidates. One common problem in writing essay questions is expecting candidates to give an answer that is not explicitly requested in the question.
2. **Make sure each requirement has a limited number of answers that experts would agree are acceptable.** Different candidates will express correct answers to most essay items in similar, but not identical, ways. However, each requirement should be worded to focus the candidate on the knowledge and skill it is supposed to elicit. If a requirement is worded in such a way that candidates legitimately may interpret it in several ways, then a variety of answers may be cor-

rect, not just those intended by the writer. This makes grading difficult and it may even invalidate the question on two grounds: 1) the knowledge and skills elicited may differ from those intended, making inferences about the scores from the item uninterpretable, and 2) because the grader must evaluate each response against multiple sets of possible correct answers, grading accuracy likely will suffer. Finally, even where the requirement is targeted accurately, if authorities cannot agree on one, or at least a small number of acceptable solutions, grading is likely to be unreliable and possibly inequitable.

3. **For essays, write questions that will elicit target writing skills.** Essays should elicit the kind of writing new CPAs may have to do. The item should be structured so that new CPAs would produce responses that reflect the target writing skills.

CAUTION: When essay questions are to be graded for both content and written presentation, writers should be careful not to make the content so difficult that candidates cannot write an answer that reflects their writing skills.

Style/Editorial Guidelines

The principles of good writing also apply to question writing. Clear and concise fact patterns and requirements are most likely to elicit accurate assessments of candidates' knowledge and skills. Jargon should be used only when it is consistent with good writing principles. Vocabulary should be at a level consistent with assessing the target knowledge and skills of a new CPA.

Guidelines for style are maintained by the Board of Examiners to ensure consistency across Uniform CPA Examination sections and administrations as much as possible. To maintain uniformity, the Board of Examiners has approved the following editorial guidelines. These guidelines pertain to all question formats.

1. **Avoid references to gender, race, or ethnicity in names of people and corporations.** For example: Smith or Jones is preferable to Jane, John, he, or she. Also, do not always make the man the breadwinner, or the woman a nurse or flight attendant. Stereotyped references like these may result in test scores that are invalid and may offend some candidates unnecessarily. If gender, race, or ethnic references are unavoidable, they should be used equitably.
2. **Use short names.** This minimizes unnecessary reading time for candidates.
3. **Avoid using the names of well-known companies/corporations.** In addition to possible legal action by the company, candidates familiar with, or working for, the company could respond based on their knowledge or their affiliation. Also, do not use humorous names or names of real people.
4. **Use the term *What amount*, instead of *How much*, when directing a candidate to select a monetary option.**
5. **Bold-face type should be used for negative words appearing in the last sentence of the item stem and in any answer option.** For example: "Which of the following statements is **not . . .**," or "All of the following are true **except . . .**" An exception to this rule is when the negative is the first word of an option. (See Chapter 3 regarding avoidance of negative phrasing.)
6. **Generally, it is unnecessary to refer to the authoritative pronouncement on which an item is based, except to clarify the focus of the question for candidates.** For situations in which it

is beneficial (such as when a pronouncement is new or is not yet effective), the reference should include the full title of the pronouncement, such as “Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*,” or “Statement on Auditing Standards No. 58, *Reports on Audited Financial Statements*.”

7. **Use *Which of the following options*, not *Which one of the following options*.**
8. **Avoid using the phrase *if any* in a multiple-choice stem, where one of the options is \$0 or none.**
9. **The following phrases are implicit in the instructions to candidates and should be used only when actually needed.**
 - “In conformity with generally accepted accounting principles”
 - “Under the circumstances described above”
 - “Based on the information given”
 - “Appropriately” or “properly” (as in “Taft appropriately uses the installment sales method.”)
10. ***Rounded to the nearest dollar or rounded to the nearest penny* should never be used in objective questions and should be avoided in essay questions.**
11. **Insert a comma before the word *and* when a set of at least three items is used.** For example: “property, plant, and equipment” is correct.
12. **Use a comma after the year stated in a complete date; do not use a comma between the month and year stated in a date.** The following are correct: “In January 1995, Smith borrowed . . .” “A note was issued on January 2, 1995, in the amount of . . .” If two years are mentioned, in a complete date, a comma should precede the first year and follow the second year. For example “December 31, 1995 and 1996, . . .”
13. **Do not insert a comma after *Inc.* unless otherwise required for grammatical accuracy.** For example, as in a prepositional phrase or as part of the description of a company.
14. **Company should be abbreviated *Co.*, and corporation *Corp.*** For example: “Dex Company” and “Dex Corporation” should be “Dex Co.” and “Dex Corp.,” respectively.
15. **Do not use the word *the* preceding company names.** For example: “The Taft Co.” is incorrect. “Taft Co.” is correct.
16. **When an abbreviation ends a sentence, no additional period is needed.** For example: “Dex Co.” is incorrect. “Dex Co.” is correct.
17. **Once the full name of an organization has been stated, subsequent references to the entity should be abbreviated.** For example, subsequent references to Lane Corp. or Maple Township would be Lane or Maple, respectively.
18. **Avoid using acronyms or abbreviations whenever possible.** Abbreviations that are widely used in accounting publications are acceptable, such as FIFO, LIFO, or IRS.

19. Refer to items *in the balance sheet* (income statement), not *on the balance sheet* (income statement).
20. Use the word *reported*, not *recorded*, *shown*, or *included*, when referring to financial statements.
21. Use the term *par*, not *par value*, when referring to capital stock. Use the term *carrying amount*, not *carrying value*.
22. The term *calendar year* is not needed if the entity's year end is December 31. Also, the word *fiscal* is not needed when referring to the entity's accounting period.
23. In presenting columnar headings for comparative financial statements, the most recent year should be stated in the first column. For example:

Year ended 1995	Year ended 1994
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24. Financial statement titles should not be placed between quotation marks.
25. Capitalize only the first word of financial statement and account titles. For example: *Statement of Retained Earnings* is incorrect. *Statement of retained earnings* is correct. Also, *Accounts Receivable* is incorrect. *Accounts receivable* is correct.
26. Use the active voice whenever reasonable. The active voice generally is shorter and clearer than the passive voice. For example:
 Passive voice: "Securities were sold by Acme Co." Active voice: "Acme Co. sold securities."
27. Avoid possessive prepositional phrases. For example: "the customer of Z Corp." can be shortened to "Z Corp.'s customer." Exception: When there are two possessives in succession, keep one as a prepositional phrase. For example, "The reporting of the accounts receivable of Z Corp.," would be rephrased, "The reporting of Z Corp.'s accounts receivable."

28. **Rules for hyphenation**

Do not hyphenate most compounds formed with prefixes such as: anti, co, de, macro, micro, non, pre, re, semi, sub, trans, un.

Hyphenate compounds with the words *all* and *self* as prefixes, e.g., *all-important*, *self-confident*. Do not hyphenate adjectival combinations of adverb + adjective or adverb + participle unless the adverb does not end in *ly* and can be misread as an adjective. For example, "completely-broken-down neighborhood" is incorrect. "Completely broken-down neighborhood" is correct.

Hyphenate compound modifiers preceding nouns. For example, “direct materials” should not be hyphenated; however, “direct-materials usage” does receive a hyphen. Other examples include:

No Hyphen

after tax
dollar value
lump sum
tax exempt
tax planning
time sharing
wholly owned
work in process
year end

Hyphen

after-tax income
dollar-value LIFO inventory method
lump-sum payment
tax-exempt organization
tax-planning tips
time-sharing plan
wholly-owned subsidiary
work-in-process inventory
year-end basis

The following words should not be hyphenated or broken into two words:

bookkeeping, markdown, markup, payback, payout, printout

The following word pairs should not be combined:

working papers, freight in, freight out

29. **Use of *that* and *which*:**

The standard rule is *that* should be used only to introduce restrictive/defining clauses—those clauses that impart information needed to identify the entity they are modifying. *That* should never be preceded by a comma. For example:

Pine Manufacturing Co. had a contract with Duff that is recorded at \$500,000 on July 1, 1995.

Which should be used to introduce nonrestrictive/nondefining clauses—those clauses that give descriptive information not strictly essential to the sentence. *Which* should always be preceded by a comma. For example:

Pine, which is a manufacturing company, had a contract with Duff.

There are times when *that/which* is implied, and can be excluded from the sentence. For example:

Pine, a manufacturing company, had a contract with Duff.

In addition, there are times when either *that* or *which* may be used to form a grammatically correct sentence, but the resulting meaning differs. For example:

Tech Co. sold its marketable securities, which had appreciated in value, and then repurchased them the same day.

Tech Co. sold its marketable securities that had appreciated in value and then repurchased them the same day.

In the first example, the sentence implies that Tech's marketable securities all had appreciated in value, were sold, and then repurchased. The second example implies that Tech sold and repurchased only those marketable securities that had appreciated in value. Those marketable securities may only be a portion of Tech's marketable securities. Question writers should make certain the phrasing used is the one they have intended.

Uniform CPA Examination Content Specifications¹

The content of the Uniform CPA Examination is based primarily on the results of two national studies of public accounting practice and the evaluations of CPA practitioners and educators. The content for each examination section is described in outline form. These outlines provide a framework, or “blueprint,” for the knowledge and skills tested on the CPA Examination. The percentage following each major content area in the outlines, preceded by roman numerals, represents the approximate weight given to the content area. The examination items are selected from the content represented by the capital letters and numerals listed under each roman numeral.

In addition to testing technical knowledge and skills, selected essays on the Auditing, Financial Accounting & Reporting, and Business Law & Professional Responsibilities sections are graded for writing skills. Evaluation of candidates’ writing skills in each of these three sections accounts for 5% of the respective section’s grade.

Auditing

The auditing section covers knowledge of generally accepted auditing standards and procedures and the skills needed to apply them in auditing and other attestation engagements. This section tests that knowledge and those skills, as appropriate, in the context of the four broad engagement tasks that follow.

Auditing content specification outline

- I. Evaluate the prospective client and engagement, decide whether to accept or continue the client and the engagement, enter into an agreement with the client, and plan the engagement (40%)
 - A. Determine nature and scope of engagement
 1. Generally accepted auditing standards
 2. Standards for accounting and review services

¹ These content specifications, effective May 1996, are taken from *Information for Uniform CPA Examination Candidates* (twelfth edition).

3. Standards for attestation engagements
 4. Compliance auditing applicable to governmental entities and other recipients of governmental financial assistance
 5. Filings under federal securities statutes
 6. Letters for underwriters and certain other requesting parties
- B. Assess engagement risk and the CPA firm's ability to perform the engagement
 1. Engagement responsibilities
 2. Staffing and supervision requirements
 3. Quality control considerations
 4. Management integrity
 - C. Communicate with the predecessor accountant/auditor
 - D. Decide whether to accept or continue the client and engagement
 - E. Enter into an agreement with the client as to the terms of the engagement
 - F. Obtain an understanding of the client's operations, business, and industry
 - G. Perform analytical procedures
 - H. Determine preliminary engagement materiality
 - I. Assess inherent risk and risk of misstatements
 1. Errors (inadvertent misstatements)
 2. Irregularities (intentional misstatements)
 3. Illegal acts by clients
 - J. Consider the internal control structure
 1. Obtain and document an understanding of the internal control structure
 2. Assess control risk
 3. Assess override and collusion risk
 - K. Consider other planning matters
 1. Using the work of other independent auditors
 2. Using the work of a specialist
 3. Internal audit function
 4. Related parties and related party transactions
 5. Segment information
 6. Interim financial information
 - L. Identify financial statement assertions and formulate audit objectives
 1. Accounting estimates
 2. Routine financial statement balances, classes of transactions, and disclosures
 3. Unusual financial statement balances, classes of transactions, and disclosures
 - M. Determine and prepare the work program defining the nature, timing, and extent of the auditor's procedures
 1. Tests of controls
 2. Analytical procedures

3. Confirmation of balances and/or transactions with third parties
4. Physical examination of inventories and other assets
5. Other tests of details
6. Substantive tests prior to the balance sheet date

II. Obtain and document information to form a basis for conclusions (35%)

A. Perform planned procedures including planned applications of audit sampling

1. Tests of controls
2. Analytical procedures
3. Confirmation of balances and/or transactions with third parties
4. Physical examination of inventories and other assets
5. Other tests of details
6. Substantive tests prior to the balance sheet date

B. Evaluate contingencies and obtain and evaluate lawyer's letter

C. Review subsequent events

D. Obtain representations from management

E. Identify reportable conditions and other control deficiencies

F. Identify matters for communication with audit committees

G. Review unusual year-end transactions

III. Review the engagement to provide reasonable assurance that objectives are achieved and evaluate information obtained to reach and to document engagement conclusions (5%)

A. Perform analytical procedures

B. Evaluate the sufficiency and competence of audit evidence and document engagement conclusions

1. Consider substantial doubt about an entity's ability to continue as a going concern
2. Evaluate whether financial statements are free of material misstatements, either inadvertent or intentional, and in conformity with generally accepted accounting principles or an other comprehensive basis of accounting
3. Consider other information in documents containing audited financial statements

C. Review the work performed to provide reasonable assurance that objectives are achieved

IV. Prepare communications to satisfy engagement objectives (20%)

A. Prepare reports

1. Reports on audited financial statements
2. Reports on reviewed and compiled financial statements
3. Reports required by *Government Auditing Standards*

4. Reports on compliance with laws and regulations
5. Reports on internal control
6. Reports on prospective financial information
7. Reports on other attestation engagements
8. Reports on the processing of transactions by service organizations
9. Reports on elements of financial statements
10. Reports on supplementary financial information
11. Reissuance of auditors' reports

B. Prepare letters and other required communications

1. Errors and irregularities
2. Illegal acts
3. Special reports
4. Communication with audit committees
5. Other reporting considerations covered by statements on auditing standards and statements on standards for attestation engagements

C. Other matters

1. Subsequent discovery of facts existing at the date of the auditor's report
2. Consideration of omitted procedures after the report date

Suggested publications to study – auditing

- AICPA Statements on Auditing Standards
- AICPA Statements on Standards for Accounting and Review Services
- AICPA Statements on Quality Control Standards
- AICPA Statements on Standards for Attestation Engagements
- U.S. General Accounting Office *Government Auditing Standards*
- AICPA Audit and Accounting Guides:
 - Audit Sampling
 - Audits of State and Local Governmental Units
 - Consideration of the Internal Control Structure in a Financial Statement Audit
- Books and articles on auditing
- Committee of Sponsoring Organizations of the Treadway Commission: *Internal Control—Integrated Framework*

Financial accounting & reporting

The financial accounting & reporting section tests candidates' knowledge of generally accepted accounting principles for business enterprises and the skills needed to apply them in a public accounting engagement. Content covered in this section includes financial accounting concepts and standards as well as their application in a public accounting engagement. Candidates will

- Obtain and document entity information for use in financial statement presentations
- Evaluate, analyze, and process entity information for reporting in financial statements
- Communicate entity information and conclusions
- Analyze information and identify data relevant to financial accounting and reporting
- Identify financial accounting and reporting methods and select those that are suitable
- Perform calculations and formulate conclusions
- Present results in writing in a financial statement format or other appropriate format

Financial accounting & reporting content specification outline

- I. Concepts and standards for financial statements (20%)
 - A. Financial accounting concepts
 - B. Financial accounting standards for presentation and disclosures in general purpose financial statements
 1. Consolidated and combined financial statements
 2. Balance sheet
 3. Statement of income and changes in equity accounts
 4. Statement of cash flows
 5. Accounting policies and other notes to financial statements
 - C. Other presentations of financial data
 1. Financial statements prepared in conformity with comprehensive bases of accounting other than generally accepted accounting principles
 2. Personal financial statements

- II. Recognition, measurement, valuation, and presentation of typical items in financial statements in conformity with generally accepted accounting principles (40%)
 - A. Cash, cash equivalents, and marketable securities
 - B. Receivables
 - C. Inventories
 - D. Property, plant, and equipment
 - E. Investments
 - F. Intangible and other assets
 - G. Payables and accruals
 - H. Deferred revenues
 - I. Notes and bonds payable
 - J. Other liabilities
 - K. Contingent liabilities and commitments
 - L. Equity accounts
 1. Corporations
 2. Partnerships

- 3. Proprietorships
 - M. Revenue, cost, and expense accounts
 - N. Financing, investing, and operating components of cash flows

- III. Recognition, measurement, valuation, and presentation of specific types of transactions and events in financial statements in conformity with generally accepted accounting principles (40%)
 - A. Accounting changes and corrections of errors
 - B. Business combinations
 - C. Discontinued operations
 - D. Employee benefits
 - 1. Deferred compensation agreements
 - 2. Paid absences
 - 3. Pension plans
 - 4. Postemployment benefits other than pensions
 - 5. Stock purchase and stock option plans
 - E. Extinguishment and restructuring of debt
 - F. Extraordinary items
 - G. Financial instruments requiring recognition or disclosure in financial statements
 - 1. Futures contracts
 - 2. Concentration of credit risk
 - 3. Disclosure of fair values
 - 4. Other contractual obligations
 - H. Foreign currency transactions and translation
 - I. Income taxes
 - J. Interest costs
 - K. Interim financial reporting
 - L. Leases
 - M. Lending activities
 - N. Nonmonetary transactions
 - O. Public companies
 - 1. Earnings per share
 - 2. Segment reporting
 - P. Quasi reorganizations, reorganizations, and changes in entity
 - Q. Real estate transactions
 - R. Related parties
 - S. Research and development costs

Suggested publications to study – financial accounting & reporting

- Financial Accounting Standards Board (FASB) Statements of Financial Accounting Standards and Interpretations, Accounting Principles Board Opinions, and AICPA Accounting Research Bulletins
- FASB Technical Bulletins
- Statement on Auditing Standards No. 69, “The Meaning of *Present Fairly in Conformity with Generally Accepted Accounting Principles* in the Independent Auditor’s Report” and Statement on Auditing Standards No. 62, “Special Reports”
- AICPA Audit and Accounting Guide for Personal Financial Statements
- FASB Statements of Financial Accounting Concepts
- AICPA Statements of Position
- Books and articles on accounting

Accounting & reporting – taxation, managerial, and governmental and not-for-profit organizations

Accounting & reporting – taxation, managerial, and governmental and not-for-profit organizations tests candidates’ knowledge of principles and procedures for federal taxation, managerial accounting, and accounting for governmental and not-for-profit organizations, and the skills needed to apply them in a public accounting engagement.

Federal taxation

This portion covers knowledge applicable to federal taxation and its application in practice. Candidates will

- Analyze information and identify data relevant for tax purposes
- Identify issues, elections, and alternative tax treatments
- Perform required calculations
- Formulate conclusions

Federal taxation content specification outline

- I. Federal taxation – individuals (20%)
 - A. Inclusions in gross income
 - B. Exclusions and adjustments to arrive at adjusted gross income
 - C. Deductions from adjusted gross income
 - D. Filing status and exemptions
 - E. Tax accounting methods
 - F. Tax computations, credits, and penalties
 - G. Alternative minimum tax
 - H. Tax procedures

II. Federal taxation — corporations (20%)

- A. Determination of taxable income or loss
- B. Tax accounting methods
- C. S corporations
- D. Personal holding companies
- E. Consolidated returns
- F. Tax computations, credits, and penalties
- G. Alternative minimum tax
- H. Other
 - 1. Distributions
 - 2. Incorporation, reorganization, liquidation, and dissolution
 - 3. Tax procedures

III. Federal taxation — partnerships (10%)

- A. Basis of partner's interest and bases of assets contributed to the partnership
- B. Determination of partner's share of income, credits, and deductions
- C. Partnership and partner elections
- D. Partner dealing with own partnership
- E. Treatment of partnership liabilities
- F. Distribution of partnership assets
- G. Termination of partnership

IV. Federal taxation — estates and trusts, exempt organizations, and preparers' responsibilities (10%)

- A. Estates and trusts
 - 1. Income taxation
 - 2. Determination of beneficiary's share of taxable income
 - 3. Estates and gift taxation
- B. Exempt organizations
 - 1. Types of organizations
 - 2. Requirements for exemption
 - 3. Unrelated business income tax
- C. Preparers' responsibilities

Suggested publications to study — federal taxation

- Internal Revenue Code and Income Tax Regulations
- Internal Revenue Service Circular 230

- AICPA Statements on Responsibilities in Tax Practice
- Income tax textbooks

Governmental and not-for-profit organizations

This portion covers knowledge applicable to accounting for governmental and not-for-profit organizations and its application in practice. Candidates will

- Analyze and identify information relevant to governmental and not-for-profit accounting and reporting
- Identify alternative accounting and reporting policies and select those appropriate in specific situations
- Distinguish the relative weight of authority of differing sources of generally accepted accounting principles
- Perform procedures, formulate conclusions, and present results

Governmental and not-for-profit organizations content specification outline

V. Accounting for governmental and not-for-profit organizations (30%)

A. Governmental organizations

1. Measurement focus and basis of accounting
2. Objectives of financial reporting
3. Uses of fund accounting
4. Budgetary process
5. Financial reporting entity
6. Elements of financial statements
7. Conceptual reporting issues

B. Not-for-profit organizations

1. Objectives of financial reporting
2. Elements of financial statements
3. Formats of financial statements

C. Accounting and financial reporting for governmental organizations

1. Governmental-type funds and account groups
2. Proprietary-type funds
3. Fiduciary-type funds

D. Accounting and financial reporting for not-for-profit organizations

1. Revenues and contributions
2. Restrictions on resources
3. Expenses, including depreciation

Suggested publications to study – governmental and not-for-profit organizations

- Governmental Accounting Standards Board (GASB) Statements, Interpretations, and Technical Bulletins
- Financial Accounting Standards Board (FASB) Statements of Financial Accounting Standards and Interpretations, Accounting Principles Board Opinions, AICPA Accounting Research Bulletins, and FASB Technical Bulletins
- FASB Statement of Financial Accounting Concepts No. 4, “Objectives of Financial Reporting by Nonbusiness Organizations” and FASB Statement of Financial Concepts No. 6, “Elements of Financial Statements”
- AICPA Statement on Auditing Standards No. 69, “The Meaning of *Present Fairly in Conformity with Generally Accepted Accounting Principles* in the Independent Auditor’s Report”
- AICPA Audit and Accounting Guides and Statements of Position relating to governmental and not-for-profit organizations
- Governmental and not-for-profit accounting textbooks and other accounting textbooks containing pertinent chapters

Managerial accounting

This portion covers knowledge applicable to managerial accounting and its application in accounting practice. Candidates will

- Analyze and interpret information as a basis for decision making
- Determine product and service costs
- Prepare and interpret information for planning and control

Managerial accounting content specification outline

VI. Managerial accounting (10%)

- A. Cost estimation, cost determination, and cost drivers
- B. Job costing, process costing, and activity based costing
- C. Standard costing and flexible budgeting
- D. Inventory planning, inventory control, and just-in-time purchasing
- E. Budgeting and responsibility accounting
- F. Variable and absorption costing
- G. Cost-volume-profit analysis
- H. Cost allocation and transfer pricing
- I. Joint and by-product costing
- J. Capital budgeting
- K. Special analyses for decision making
- L. Product and service pricing

Suggested publications to study – managerial accounting

- Managerial accounting textbooks and other accounting textbooks containing pertinent chapters
- Accounting periodicals

Business law & professional responsibilities

The business law & professional responsibilities section tests candidates' knowledge of a CPA's professional responsibilities and of the legal implications of business transactions, particularly as they relate to accounting and auditing. Content covered in this section includes a CPA's professional responsibilities, business organizations, contracts, debtor-creditor relationships, government regulation of business, the Uniform Commercial Code, and property. Candidates will be required to

- Recognize relevant legal issues
- Recognize the legal implications of certain business situations
- Apply the underlying principles of law to accounting and auditing situations

This section deals with federal and widely adopted uniform laws. If there is no federal or uniform law on a topic, the questions are intended to test knowledge of the law of the majority of jurisdictions. Professional ethics questions are based on the AICPA Code of Professional Conduct because it is national in its application, whereas codes of other organizations and jurisdictions may be limited in their applications.

Business law & professional responsibilities content specification outline

- I. Professional and legal responsibilities (15%)
 - A. Code of professional conduct
 - B. Proficiency, independence, and due care
 - C. Responsibilities in other professional services
 - D. Disciplinary systems within the profession
 - E. Common law liability to clients and third parties
 - F. Federal statutory liability
 - G. Privileged communications and confidentiality

- II. Business organizations (20%)
 - A. Agency
 1. Formation and termination
 2. Duties of agents and principals
 3. Liabilities and authority of agents and principals
 - B. Partnership and joint ventures
 1. Formation, operation, and termination

2. Liabilities and authority of partners and joint owners
- C. Corporations
 1. Formation and operation
 2. Stockholders, directors, and officers
 3. Financial structure, capital, and distributions
 4. Reorganization and dissolution
 - D. Estates and trusts
 1. Formation, operation, and termination
 2. Allocation between principal and income
 3. Fiduciary responsibilities
 4. Distributions
- III. Contracts (10%)
- A. Formation
 - B. Performance
 - C. Third party assignments
 - D. Discharge, breach, and remedies
- IV. Debtor-creditor relationships (10%)
- A. Rights, duties, and liabilities of debtors and creditors
 - B. Rights, duties, and liabilities of guarantors
 - C. Bankruptcy
- V. Government regulation of business (15%)
- A. Federal securities acts
 - B. Employment regulation
 - C. Environmental regulation
- VI. Uniform commercial code (20%)
- A. Commercial paper
 - B. Sales
 - C. Secured transactions
 - D. Bailments and documents of title

VII. Property (10%)

- A. Real property**
- B. Personal property**
- C. Fire insurance**

Suggested publications to study – business law & professional responsibilities

- **AICPA Code of Professional Conduct**
- **AICPA Statements on Auditing Standards dealing explicitly with proficiency, independence, and due care**
- **AICPA professional standards covering consulting services and personal financial planning**
- **Books covering business law, auditing, and accounting**

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