

1-1-2000

Information for uniform CPA examination candidates, effective November 2000

American Institute of Certified Public Accountants

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Information for Uniform CPA Examination Candidates

AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

SIXTEENTH EDITION • EFFECTIVE NOVEMBER 2000

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This booklet was prepared by the Board of Examiners of the American Institute of Certified Public Accountants. Under the bylaws of the Institute, the Board is responsible for supervising the preparation of the Uniform CPA Examination and conducting the Advisory Grading Service. This booklet is an expression of the Board's policy for these activities. The Board expresses its appreciation to the National Association of State Boards of Accountancy and the state boards of accountancy for reviewing this booklet.

This booklet has not been formally approved by the AICPA Council or membership. Therefore, it does not represent an official position of the American Institute of Certified Public Accountants.

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Preface

The information provided in this booklet is intended to help candidates prepare for and write the Uniform Certified Public Accountant (CPA) Examination. The sixteenth edition incorporates the latest changes to the Business Law & Professional Responsibilities Content Specifications and revised “Cheating” and “Focus of the Examination” sections.

There is a continuing need for CPAs, and the accounting profession welcomes all qualified persons to its ranks. The Uniform CPA Examination is a measure of professional competence and establishes the CPA certificate as evidence of professional qualification.

The Uniform CPA Examination and the Advisory Grading Service were first made available by the American Institute of Certified Public Accountants in June 1917. Eventually, these examination services were adopted by all states, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. As a result, the CPA certificates of all jurisdictions are substantially on the same footing, a condition that has enhanced the national prestige of the CPA designation and has aided the interstate practice of public accounting.

I urge those interested in becoming CPAs to read this booklet carefully.

Barry Melancon, *President*
American Institute of Certified Public Accountants

New York
June 2000

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Introduction

This document has been prepared by the Board of Examiners of the American Institute of Certified Public Accountants (AICPA) and is intended for those preparing to take the Uniform Certified Public Accountant Examination. Individuals who want information on how to apply to become a CPA should contact the board of accountancy in the jurisdiction from which they seek the CPA certificate.

Certified Public Accountant

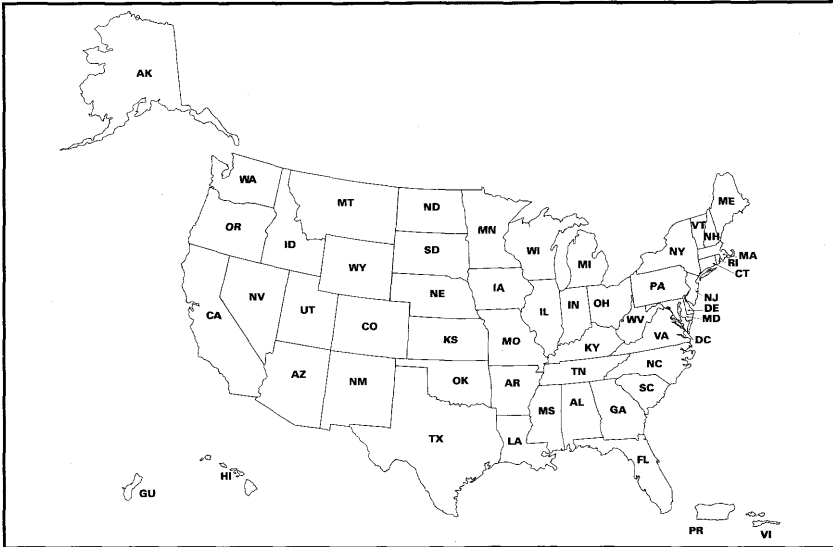
Certified Public Accountant (CPA) is a credential conferred by a state or similar governmental jurisdiction that authorizes the holder to practice as a certified public accountant in that jurisdiction. Licensing of CPAs helps to protect the public because only those individuals who have met prescribed requirements are permitted to hold themselves out to the public as certified public accountants. The public is also protected from substandard work performed by incompetent individuals.

Boards of Accountancy

Specific requirements for becoming a CPA and the rights and obligations of a licensed CPA are set forth in the laws and regulations of fifty-four United States jurisdictions. These jurisdictions appear on the map on page 2. For a complete directory of the boards of accountancy, see Appendix C.

The laws of each jurisdiction establish a board of accountancy as an administrative branch of the jurisdiction's government. The board is responsible for safeguarding the public interest by ensuring the competence and integrity of those who hold a CPA certificate or license. The board evaluates the qualifications of candidates, administers examinations, issues certificates and licenses to practice, promulgates rules of professional conduct, investigates complaints, holds hearings, and takes disciplinary action.

Every jurisdiction has specific requirements that a candidate must meet to become licensed as a certified public accountant, and all jurisdictions require candidates to pass the Uniform CPA Examination. The other requirements vary among the jurisdictions and may include education, an ethics examination, and experience.



Those who practice as CPAs must understand and abide by the specific laws and regulations of the jurisdiction in which they practice.

National Association of State Boards of Accountancy

The National Association of State Boards of Accountancy (NASBA) is a voluntary organization that serves as a forum for the fifty-four boards of accountancy. Two of its standing committees are:

- The Examinations Committee, which investigates and makes recommendations to boards of accountancy regarding all aspects of the Uniform CPA Examination.
- The CPA Examination Review Board, which provides a comprehensive audit of the preparation, grading, security, and administration of the examination.

NASBA also provides numerous programs and services to enhance the effectiveness of the boards of accountancy, including the Grade Reporting and Statistical Information Program, which assists the boards of accountancy in processing examination grades and in compiling jurisdictional and national statistical information on examination performance.

Additional information about NASBA may be obtained by writing to NASBA, 150 Fourth Avenue North, Suite 700, Nashville, TN 37219-2417, or by accessing its Website (www.nasba.org).

The Uniform CPA Examination

Background

Examinations were first used to test the qualifications of public accountants in New York State in 1896. As the country and profession grew, more states enacted accountancy laws that required individuals to pass an examination to qualify as certified public accountants. The Uniform CPA Examination was first administered in 1917. By the 1960s, all jurisdictions in the United States required new CPAs to have passed the Uniform CPA Examination prepared by the AICPA and graded by its Advisory Grading Service. Acceptance of the Uniform CPA Examination by all jurisdictions has greatly improved the ability of CPAs to obtain reciprocal recognition from other jurisdictions.

Nondisclosure of Examination Questions and Answers

The Uniform CPA Examination is *nondisclosed*, which means that the questions remain secure after the examination has been administered. However, the AICPA publishes questions that have been used on the examination, but will not be used on future examinations, in several publications (see “Study Aids”).

Nondisclosure enhances the quality of the examination by permitting pretesting of questions (see “Pretesting”) and by allowing equating. *Equating* is a statistical process that is used to adjust scores on different examinations so that the scores are interchangeable. Equating adjusts for difficulty among test forms that are developed to be similar in difficulty and content.

Because some examination questions will appear on future examinations, candidates and others must not disclose the questions after the examination has been administered. Candidates are required to read the following Statement of Confidentiality on each Uniform CPA Examination Booklet and to sign and date the front of the Booklet, signifying that they agree to comply with the policy, before they are allowed to open the Booklet.

I hereby attest that I will not divulge the nature or content of any question or answer to any individual or entity, and I will report to the board of accountancy any solicitations and disclosures of which I become aware. I will not remove, or attempt to remove, any Uniform CPA Examination materials, notes, or other unauthorized materials from the examination room. I understand that failure to comply with this attestation may result in the invalidation of my grades, disqualification from future examinations, and possible civil and criminal penalties.

The statutes and rules of the fifty-four jurisdictions stipulate various penalties for disclosing examination material. These differ across jurisdictions but may include withholding examination grades and administrative and legal penalties.

The Board of Examiners and the Examinations Team

The Board of Examiners (the Board) is an executive committee of the AICPA with overall responsibility for preparing and grading the Uniform CPA Examination. This responsibility is carried out with the assistance of four committees that report to the Board: Content, Executive, Operations, and Psychometric Oversight. The members of the Board include the chair of each committee, members from the Preparation Subcommittees and from the Psychometric Committee, and CPAs with relevant experience.

The Content Committee is responsible for overseeing the development of the individual sections of the examination, the proper scoring of the examination, and ongoing analyses to ensure that the content reflects entry-level practice. It is responsible for establishing appropriate passing standards and the grading bases for each examination section, as discussed in the section “Grading the Examination.”

The Content Committee oversees the Preparation Subcommittees. The Auditing and Business Law & Professional Responsibilities Preparation Subcommittees are responsible for preparing their respective examination sections. The Accounting & Reporting Preparation Subcommittee is responsible for preparing two examination sections: Financial Accounting & Reporting and Accounting & Reporting—Taxation, Managerial, and Governmental and Not-for-Profit Organizations. These three subcommittees review questions and unofficial answers for technical accuracy, relevance to

practice as a CPA, compliance with content specification outlines, and appropriate range and level of knowledge and skills needed to practice as a CPA.

Members of the Content Committee and the Preparation Subcommittees are practitioners or educators selected for their knowledge of the subject matter relevant to practice as a CPA.

The Executive Committee assists the Board in identifying strategic planning and risk assessment issues. The Operations Committee is responsible for oversight of all operational aspects of the testing program. The Psychometric Oversight Committee is responsible for critical review of psychometric procedures, evaluation of research and other analytical studies, and identification of areas that would benefit from employing results of recent research.

The AICPA Examinations Team, which carries out the Board's policies, includes CPAs and attorneys; testing specialists; desktop publishing professionals; systems management personnel; and administrative personnel. The staff is responsible for developing, producing, shipping, and grading the Uniform CPA Examination.

Additional information about the Uniform CPA Examination, the Board of Examiners, and the Examinations Team is available on the AICPA's Website (*AICPA Online*: www.aicpa.org; *Examinations Team*: www.aicpa.org/exams). The Examinations Team has posted sample examination questions and frequently asked questions, among other documents, on the AICPA's Website.

Examination Dates, Structure, and Times

The Uniform CPA Examination is given twice each year, in May and November. All boards of accountancy mail grades to candidates on the same date, which is approximately 90 days after the examination has been administered. The following chart lists upcoming examination administrations and the corresponding dates grades will be mailed.

<i>Examination Administration</i>	<i>Date Grades Will Be Mailed</i>
November 3 and 4, 1999	January 31, 2000
May 3 and 4, 2000	July 31, 2000
November 1 and 2, 2000	January 29, 2001
May 2 and 3, 2001	July 30, 2001
November 7 and 8, 2001	February 4, 2002
May 8 and 9, 2002	August 5, 2002
November 6 and 7, 2002	February 3, 2003

The examination is administered only within the boundaries of the fifty-four United States jurisdictions that use the examination. The examination is administered only in English, and the essays and problem solutions will be graded only if written in English.

The examination consists of four separate sections administered over a two-day period, as follows:

Section	Hours	Day	Time
Business Law & Professional Responsibilities	3.0	Wednesday	9:00 A.M.–12:00 NOON
Auditing	4.5	Wednesday	1:30 P.M.–6:00 P.M.
Accounting & Reporting— Taxation, Managerial, and Governmental and Not-for- Profit Organizations	3.5	Thursday	8:30 A.M.–12:00 NOON
Financial Accounting & Reporting	4.5	Thursday	1:30 P.M.–6:00 P.M.
Total	<u>15.5</u>		

Candidates' knowledge and skills are assessed by requiring responses to questions in three different formats:

- Four-option multiple-choice
- Other objective answer
- Essay question or problem

The percentages of examination questions in each format in each section are:

Section	Format		
	Four-Option Multiple-Choice	Other Objective Answer	Essay Questions or Problems
Business Law & Professional Responsibilities	50 – 60%	20 – 30%	20 – 30%
Auditing	50 – 60%	20 – 30%	20 – 30%
Accounting & Reporting— Taxation, Managerial, and Governmental and Not-for- Profit Organizations	50 – 60%	40 – 50%	None
Financial Accounting & Reporting	50 – 60%	20 – 30%	20 – 30%

Pretesting

Approximately 10 to 15 percent of the questions are included for pretesting only. *Pretesting* means that questions are embedded in an examination and are not used in computing a candidate's final grade. Pretested questions that meet standards for quality are included in future examinations; those that do not are discarded.

The ability to pretest questions improves the quality of future examinations by ensuring that only high-quality questions are included in the examination grades and by contributing to a more consistent level of examination difficulty.

Cheating

Boards of accountancy and the Board of Examiners take cheating on the Uniform CPA Examination very seriously. If a board of accountancy determines that a candidate has cheated, the candidate will be subject to a variety of penalties including, but not limited to, invalidation of grades, disqualification from subsequent examination administrations, and civil and criminal penalties. In cases where cheating is discovered after a candidate has obtained a CPA certificate, a board may rescind the certificate.

Actions that may be considered cheating include, but are not limited to:

- Falsifying credentials.
- Copying answers from another candidate during the examination.
- Helping another candidate during the examination.
- Unauthorized communication with another individual, in or out of the examination room, during the examination.
- Using unauthorized materials or equipment during the examination.
- Taking written material, notes, etc., from the examination room.
- Divulging examination information in violation of examination policies.

Boards of accountancy use a variety of procedures to prevent candidates from cheating on the examination. Proctors are trained to watch for unusual behavior and incidents during the examination and to document the occurrence of any unusual activity.

During the grading process, the AICPA Advisory Grading Service instructs graders to report all cases of unusually similar responses. After grading is complete, the Advisory Grading Service sends to each board of accountancy a report that identifies candidates whose patterns of answers are unusually similar. Boards of accountancy may use this report to support an existing investigation into possible cheating or to initiate such an investigation.

All of the examination materials are owned and copyrighted by the AICPA. Any reproduction and/or distribution of examination materials, including by memorization, without the express written

authorization of the AICPA, is prohibited. This behavior infringes on the legal rights of the AICPA and, in addition to the penalties listed above, appropriate legal action may be taken when any such infringements have occurred.

Examination Focus and Content

Focus of the Examination

The focus of the examination is on the broad range of knowledge and skills entry-level CPAs need to practice public accountancy. A candidate's knowledge and skills are assessed at three levels of cognitive complexity:

1. *Understanding*—the ability to recognize or recall learned materials and grasp the meaning.
2. *Application*—the ability to use learned materials 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 decisions, and communicate judgments to a variety of audiences.

Currently, at least 60% of each examination section assesses knowledge and skills at the application and evaluation levels.

The successful practice of public accountancy requires the CPA practitioner to have a broad knowledge base of business. The CPA candidate is expected to have knowledge of general business sufficient to understand the underlying business purpose and accounting implications of business activity.

Many questions require application and analysis of business information. Other questions, especially essays and problems, require the ability to apply evaluation, judgment, presentation, and decision-making skills to accounting and auditing information in business situations.

Examples of skills assessed on the examination follow:

- Analyzing information and identifying data relevant to the situation.
- Assessing materiality and identifying risk.
- Identifying and explaining auditing procedures, accounting and reporting situations, and potential legal issues.
- Understanding and evaluating information technology.
- Evaluating situations, formulating conclusions, and making recommendations.
- Preparing auditing and accounting findings, conclusions, and recommendations in written report format.

General Content of the Examination

The content of the 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 of each examination section is described in a combination of narrative and outline forms known as “content specifications.” These content specifications provide the framework, or “blueprint,” for testing knowledge and skills on the Uniform CPA Examination. Each major content area in the outline portions of the content specifications is preceded by a roman numeral and is followed by a percentage that represents the weight given to that content area. Examination items are selected from the content represented by the capital letters and numerals listed under each roman numeral. The content specifications for the examination are located in “Examination Content.”

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 percent of the candidate’s grade. A discussion of writing skills and writing samples are included in “Evaluation of Writing Skills.”

Study Aids

To help candidates prepare for the examination, the Examinations Team publishes several study aids. *Selected Questions & Unofficial Answers Indexed to Content Specification Outlines* includes Uniform CPA Examination questions used before May 1996 and questions from nondisclosed examinations that will not be used on future examinations. In addition, this study aid contains a chart listing the total number of multiple-choice, other objective answer format, and essay questions and problems by each section’s content specifications. The Examinations Team also publishes a Supplement to *Selected Questions & Unofficial Answers* and a Practice Examination. Both publications include questions that have appeared on the examination but will not be used on future examinations. These Examinations Team publications and others may be ordered from the AICPA by using the AICPA Uniform CPA Examination Publications Order Form (see Appendix D).

Sample questions appear in Appendix B and on the Examinations Team’s Website (<http://www.aicpa.org/exams>).

Examination Content

The content specifications have been revised to reflect changes enacted by the Board of Examiners in late 1999. These changes, effective for the November 2000 Uniform CPA Examination, encompass general business knowledge that entry-level CPAs need in the practice of public accountancy.

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 also covers knowledge of information technology and the skills needed to apply it in auditing and other attestation engagements. This section tests such knowledge and skills in the context of the four broad engagement tasks in the outline that follows.

Auditing Content Specification Outline

- I. Plan the engagement, evaluate the prospective client and engagement, decide whether to accept or continue the client and the engagement, and enter into an agreement with the client (40%)
 - A. Determine nature and scope of engagement
 1. Generally accepted auditing standards
 2. Standards for accounting and review services
 3. Standards for attestation engagements
 4. Compliance auditing applicable to governmental entities and other recipients of governmental financial assistance
 5. Other assurance services
 6. Appropriateness of engagement to meet client's needs
 - 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
5. Researching information sources for planning and performing the engagement
- 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. Consider preliminary engagement materiality
- I. Assess inherent risk and risk of misstatements
 1. Errors
 2. Fraud
 3. Illegal acts by clients
- J. Consider internal control in both manual and computerized environments
 1. Obtain an understanding of business processes and information flows
 2. Identify risks in business processes and information flows
 3. Document an understanding of internal control
 4. Consider the effects of information technology on internal control
 5. Assess control risk
 6. Consider limitations of internal control
 7. Consider the effects of service organizations on internal control
- 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. Electronic evidence

- 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
- 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. Computer assisted audit techniques, including data interrogation, extraction, and analysis
 - 7. Substantive tests prior to the balance sheet date
 - 8. Tests of unusual year-end transactions
 - B. Evaluate contingencies
 - C. Obtain and evaluate lawyers' letters
 - D. Review subsequent events
 - E. Obtain representations from management
 - F. Identify reportable conditions and other control deficiencies
 - G. Identify matters for communication with audit committees
- 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
 - 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 agreed-upon procedures
 - 8. Reports on other assurance services
 - 9. Reports on the processing of transactions by service organizations
 - 10. Reports on supplementary financial information
 - 11. Other special reports
 - 12. Reissuance of reports
 - B. Prepare letters and other required communications
 - 1. Errors and fraud
 - 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 and Interpretations
- ◆ AICPA Statements on Standards for Accounting and Review Services and Interpretations
- ◆ 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
 - Consideration of Internal Control in a Financial Statement Audit
- ◆ Textbooks and articles on auditing and other attestation services
- ◆ AICPA Auditing Procedure Studies
- ◆ AICPA Audit and Accounting Manual
- ◆ AICPA Audit Risk Alerts and Compilation and Review Alerts
- ◆ Single Audit Act, as amended
- ◆ Textbooks and articles on the information technology topics that CPAs need to understand in order to perform auditing and other attestation engagements in a computerized environment
- ◆ AICPA Technology Series

Appendix A lists information technology topics that CPAs need to understand in order to perform auditing and other attestation engagements in a computerized environment. Appendix A also provides several sample information technology questions. In addition, sample Auditing questions are included in Appendix B and on the Examination Team's Website at <http://www.aicpa.org/exams>.

Financial Accounting & Reporting

The Financial Accounting & Reporting section tests knowledge of generally accepted accounting principles for business enterprises and the skills needed to apply them in public accounting engagements. Content covered in this section includes financial accounting concepts and standards as well as their application in public accounting engagements. To demonstrate such knowledge and skills, candidates will be required to

- 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
- 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 disclosure in general purpose financial statements
 1. Consolidated and combined financial statements
 2. Balance sheet
 3. Statement(s) of income, comprehensive 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
 - 3. Prospective financial information
 - D. Financial statement analysis
- 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. Intangibles and other assets
 - G. Payables and accruals
 - H. Deferred revenues
 - I. Notes and bonds payable
 - J. Other liabilities
 - K. Equity accounts
 - L. Revenue, cost, and expense accounts
- 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. Cash flow components—financing, investing, and operating
 - D. Contingent liabilities and commitments
 - E. Discontinued operations
 - F. Earnings per share
 - G. Employee benefits
 - H. Extraordinary items

- I. Financial instruments
- J. Foreign currency transactions and translation
- K. Income taxes
- L. Interest costs
- M. Interim financial reporting
- N. Leases
- O. Nonmonetary transactions
- P. Quasi-reorganizations, reorganizations, and changes in entity
- Q. Related parties
- R. Research and development costs
- S. Segment reporting

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
- ◆ 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,” and Statement on Auditing Standards No. 62, “Special Reports”
- ◆ AICPA Personal Financial Statements Guide
- ◆ FASB Statements of Financial Accounting Concepts
- ◆ AICPA Statements of Position
- ◆ Books and articles on accounting

Sample Financial Accounting & Reporting questions are included in Appendix B and on the Examination Team’s Website at <http://www.aicpa.org/exams>.

Accounting & Reporting—Taxation, Managerial, and Governmental and Not-for-Profit Organizations

The Accounting & Reporting—Taxation, Managerial, and Governmental and Not-for-Profit Organizations section tests candidates' knowledge of principles and procedures for federal income, estate, and gift taxation, managerial accounting, and accounting for governmental and not-for-profit organizations, and tests the skills needed to apply those principles and procedures in public accounting engagements.

Federal Taxation

This portion covers knowledge applicable to federal income, estate, and gift taxation and its application in practice. To demonstrate such knowledge, candidates will be required to

- 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. Estate 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. To demonstrate such knowledge, candidates will be required to

- 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 entities
 - 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
 - 8. Accounting and financial reporting for state and local governments
 - a. Governmental-type funds and account groups
 - b. Proprietary-type funds
 - c. Fiduciary-type funds

9. Accounting and financial reporting for governmental not-for-profit organizations (including hospitals, colleges and universities, voluntary health and welfare organizations and other governmental not-for-profit organizations)
- B. Nongovernmental not-for-profit organizations
 1. Objectives of financial reporting
 2. Elements of financial statements
 3. Formats of financial statements
 4. Accounting and financial reporting for nongovernmental not-for-profit organizations
 - a. Revenues and contributions
 - b. Restrictions on resources
 - c. 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 Accounting 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
- ◆ Government Finance Officers Association, *Governmental Accounting, Auditing, and Financial Reporting* (the “Blue Book”)
- ◆ 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. To demonstrate such knowledge, candidates will be required to

- 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

Sample Accounting & Reporting questions are included in Appendix B and on the Examinations Team's Website at <http://www.aicpa.org/exams>.

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. To demonstrate such knowledge, 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 application.

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 imposed by the profession and state regulatory bodies
 - E. Common law liability to clients and third parties
 - F. Federal statutory liability
 - G. Privileged communications and confidentiality
 - H. Responsibilities of CPAs in business and industry, and in the public sector

- 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. Partnerships, joint ventures, and other unincorporated associations
 - 1. Formation, operation, and termination
 - 2. Liabilities and authority of partners and 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. Negotiable instruments
 - B. Sales
 - C. Secured transactions
 - D. Documents of title

- VII. Property (10%)
 - A. Real property including insurance
 - B. Personal property including computer technology rights

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 Statement on Standards for Consulting Services
- ◆ AICPA Statements on Responsibilities in Personal Financial Planning Practice
- ◆ Pronouncements of the Independence Standards Board
- ◆ Books covering business law, auditing, and accounting

Sample Business Law & Professional Responsibilities questions are included in Appendix B and on the Examinations Team's Website at <http://www.aicpa.org/exams>.

Effective Dates of Pronouncements

Candidates are responsible for knowing accounting and auditing pronouncements, including pronouncements in the governmental and not-for-profit organizations areas, six months after a pronouncement's *effective* date, unless early application is permitted. When early application is permitted, candidates are responsible for knowing the new pronouncement six months after the *issuance* date. In this case, candidates are responsible for knowing both the old and new pronouncements until the old pronouncement is superseded.

For the federal taxation area, candidates are responsible for knowing the Internal Revenue Code and federal tax regulations in effect six months before the examination date.

For the Business Law & Professional Responsibilities section, candidates are responsible for knowing federal laws six months after their *effective* date and uniform acts one year after their adoption by a simple majority of the jurisdictions.

Evaluation of Writing Skills

Writing Skills

Selected essay answers in the Business Law & Professional Responsibilities, Auditing, and Financial Accounting & Reporting sections are used to assess candidates' writing skills. Five percent of the total points available on each of these sections will be allocated to writing skills. Effective writing can be characterized by the following six elements:

1. *Coherent organization.* The writer arranges ideas in a smooth, logical flow, enabling the reader to easily follow the train of thought. The writer develops each main idea in a separate paragraph and places the idea in the first sentence of the paragraph. Sentences that follow describe, define, clarify, illustrate, or explain the principal idea. Connectives and transition words link sentences and paragraphs.
2. *Conciseness.* The writer conveys points in as few words as possible without scrimping on important detail or substance. Short sentences and simple wording contribute to concise writing.
3. *Clarity.* A clearly written response expresses the writer's meaning or reasoning to the intended reader. Well-constructed sentences and carefully chosen words, including proper technical terms, contribute to clarity.
4. *Use of standard English.* Effective responses use standard English, which is defined in *The Business Writer's Handbook* as follows:

There are two broad varieties of written English: standard and nonstandard. These varieties are determined through **usage** by those who write in the English language. Standard English ... is used to carry on the daily business of the nation. It is the language of business, industry, government, education, and the professions. Standard English is characterized by exacting standards of **punctuation** and capitalization, by accurate **spelling**, by exact **diction**, by an expressive vocabulary, and by knowledgeable usage choices.¹

¹ Charles T. Brusaw, Gerald J. Alred, and Walter E. Oliu, *The Business Writer's Handbook*, 4th ed. (New York: St. Martin's Press, 1993), page 227.

5. *Responsiveness to the requirements of the question.* The writer should address the requirements of the question and demonstrate awareness of the purpose of the writing task. Answers should not be broad expositions on the general subject but should focus on the specific elements presented in the question. However, answers should not be so narrowly focused that they omit key elements of the requirements.
6. *Appropriateness for the reader.* Writing that is appropriate for the reader takes into account the reader's background, knowledge of the subject, interests, and concerns. Some essay questions may require candidates to prepare a written document for a specific reader, such as a memorandum to a CPA's client. In such cases, technical terms may have to be defined for the specific reader. When the requirements do not identify a specific reader, the candidate should assume the intended reader is a knowledgeable CPA.

Writing Skills Samples

Writing skills are assessed at levels ranging from weak to very good. The following example includes a question followed by two sample answers illustrating weak writing skills and very good writing skills, respectively. Each answer is followed by an assessment of the writing skills demonstrated.

Question:

How has technology changed work in the business environment? Explain your answer with specific examples.

Weak Writing Sample:

People have to get used to new things. Like computers and Faxes and all. And they have to learn how to use things like voice mail. Which can get confusing for some people. Technology eliminates a lot of jobs because it can do things faster and better and cheaper than a lot of people. Though computers can't think. Can a computer handle a complaint from a customer? Teleconferencing helps a group of people have a group meeting over the phone. They don't have to all spend a lot of money for planes and hotels and stuff to go to a meeting. They can all stay in their own office and meet over the phone.

Assessment of Weak Writing Sample:

The passage lacks coherence. It does not introduce a principal idea and lumps various types of examples and comments together into one paragraph. Some of the material in the paragraph is irrelevant to the topic of the essay. Further, the writing jumps from one thought to another with no connecting link. The paragraph contains numerous grammatical errors, such as sentence fragments and faulty agreement. The passage does address the question, however, and answers with specifics.

Very Good Writing Sample:

As technology evolved over the last 15 years, it radically changed office equipment and the way Americans work. The word processor has replaced the typewriter and the computer has become the nerve center of the office. With the personal computer, vast amounts of information from various sources are available to office workers in an instant. Using such equipment as the modem and laptop computer, people can work almost anywhere—on planes, at home, at an off-site location. Even the telephone has seen significant change. For example, some telephones have become facsimile machines, enabling workers to transmit paper documents over telephone lines, with a paper reproduction arriving at the other end.

These kinds of technological innovations have enabled many companies to reduce expenses while improving services. For instance, with improved technology, office payroll usually can be trimmed. Expenses can be further decreased by changing from a paper-based filing system to a computer-based system. At the same time, customer service improves, as workers can respond to customer needs more quicker using faxes or voice mail. Workers can research numerous topics more quicker and thoroughly, using a variety of electronic data sources. Further, changes and updates to customer documents can be done with little delay by using a word processor.

Assessment of Very Good Writing Sample:

This essay is coherent. It introduces the principal ideas in the first sentence of each paragraph and uses the remaining sentences to explain those ideas. There is no irrelevant information in either paragraph. The passage makes its points concisely and

clearly. There are no ambiguous or misused words, and some of the vocabulary is quite expressive: “radically,” “nerve center” and “payroll can be trimmed.” The passage gets high marks for its use of standard English, as it is relatively free of errors in punctuation, spelling, and grammar. The errors “filling” and “more quicker” can be overlooked in such a well-written essay. The essay speaks to the question, answering it with specifics. The content and language are appropriate for the reader. Note the explanation of how the facsimile machine works, given just in case the reader may not know the device.

Grading the Examination

The objective of the Board of Examiners' Advisory Grading Service is to grade candidates' examination papers fairly and uniformly. This objective is attained by developing grading bases and consistently applying grading guides to candidates' answers, with as many as two subsequent reviews of each paper. Throughout the grading process, the grading of all papers is subject to very high quality controls. Therefore, although candidates may request a review of their papers, grade changes rarely occur.

Grading Guides

Grading guides for each section are created as the examination is developed and are approved by the preparation subcommittee and the Board of Examiners. The grading guides for the machine-gradable objective questions are the answer key and the point value assigned to each answer. For the essay questions and problems, the grading guides consist of the model answer, each concept being elicited, and each concept's assigned point value. For example, if a question requires a candidate to prepare an income statement, a grading concept might be "proper heading."

Grading Bases

To establish the grading bases, the grading guides are applied to a sample of papers just after the examination is administered. As a result of the sample grading, the Content Committee of the Board of Examiners may approve modifications to the grading guides.

The grading guides for the machine-gradable objective questions are analyzed during sample grading. If a substantial number of candidates select an answer different from the correct answer indicated by the grading guide, the question is submitted for review to a panel of independent experts in the field of knowledge tested. If other answers are found to be appropriate, the answer key is adjusted accordingly and all papers are regraded using the revised answer key.

For essay questions and problems, additional acceptable concepts may be identified from candidates' answers. Also, other approaches to the questions and additional interpretations of data and statements presented in the essay questions and problems are evaluated. If the alternative approaches and interpretations are judged to be acceptable by the Content Committee, the grading guide is adjusted.

After sample grading is completed, the Content Committee approves the final grading bases.

Candidate Concerns About Examination Questions

Candidates who identify possible errors in questions while taking the Uniform CPA Examination have the opportunity to request that the Advisory Grading Service review those questions. This procedure, described below, is designed to assure candidates that all technically accurate answers will be considered in the grading and to speed technical review immediately after the examination is administered.

Candidates who believe one or more questions contain errors and want their concerns evaluated must fax their comments to the AICPA (201-938-3443). The fax should include the precise nature of any error, the rationale, and, if possible, references. The fax should include the candidate's seven-digit candidate identification number and must be received by the AICPA within four days of the completion of the examination administration. This will ensure that all comments are reviewed before the grading bases for the Uniform CPA Examination are approved.

The AICPA cannot respond personally to those candidates who fax concerns; however, every fax received by the deadline is reviewed and considered in determining the grading bases.

Grading Process

The only identifying information available to the Advisory Grading Service is the candidate identification number that appears on a candidate's examination papers. It is critical that candidates carefully and accurately write and bubble in their candidate identification number on their examination papers.

Candidate anonymity is preserved throughout the grading process, as graders have no access to information about a candidate's name, education, experience, age, number of previous sittings, conditioning status, or other personal characteristics. A candidate's performance on the examination is measured solely on the basis of the answers submitted on the current examination.

Initial production grading. Objective questions are graded using an optical scanner. Samples of answer sheets are continually verified manually to ensure that the scanner has not malfunctioned.

Answers to essay questions and problems are graded by a staff of CPAs and attorneys specifically engaged for this purpose. A candidate must correctly identify all gradable concepts to earn the maximum number of points.

Graders are assigned to individual essay questions or problems and then trained intensively to apply the grading guide consistently. Consequently, graders are proficient both in the subject matter and in the evaluation of candidates' answers. This promotes grading that is both objective and uniform.

Selected essays are graded for writing skills using the holistic grading method. As the term implies, "holistic grading" treats the written passage as a whole, and graders receive intensive training in applying the holistic grading method. Graders assign a single writing skills rating based on the six characteristics listed in the section "Evaluation of Writing Skills."

First review. When initial production grading is complete, first review is performed by experienced graders who review essays or problem solutions for candidates with adjusted scores in the first review range. The first review range includes the passing grade and a range of surrounding scores. This review confirms the initial score and serves as an additional quality control mechanism over the consistency of the grading process, because reviewers are able to compare the work of different graders. In this manner, there is continual verification that all graders are properly applying the essay and problem solution grading guides. Based on this review, scores are corrected for any scoring errors.

Second review. The Advisory Grading Service performs a second review on papers with adjusted scores in the second review range when the candidate has attained adjusted scores on the other sections taken, or sections previously passed, that would allow the candidate to attain or maintain conditioning credit under the statutes, rules, and regulations of their licensing jurisdiction. The second review range is narrower than the first review range and includes the scores below the passing grade.

The second review process is as follows:

1. The accuracy of the objective answer score is verified manually.
2. A reviewer who did not perform the first review verifies the accuracy of the essay and problem grading.

Based on this review, adjusted scores are corrected for any scoring errors.

Passing Grade for Each Section

Each section of the Uniform CPA Examination is graded separately. The AICPA reports advisory grades to boards of accountancy on a scale ranging from 0 to 99, with a minimum passing grade of 75 for each section. The boards of accountancy are responsible for issuing official grades.

Setting the Passing Standard

The passing standard for each section of the Uniform CPA Examination is based on the modified Angoff passing standard studies held during 1996. For these studies, more than 100 CPAs rated the questions given on the May 1996 Examination in order to estimate the percentage of newly licensed CPAs that would answer each question correctly. The estimates were used to determine a minimum passing score, which was then converted to a grade of 75.

The minimum passing score for subsequent examinations is statistically determined through a process known as *equating*. Equating adjusts statistically for differences in the difficulty level of the examinations and differences in the ability level of the groups of candidates taking the examinations. Using this process, the score on a subsequent examination that corresponds to the same ability level as the minimum passing score on the May 1996 Examination is determined. This new minimum grade is then converted to a grade of 75. All scores above that score are assigned passing advisory grades of 75 through 99 and scores below that score are assigned failing advisory grades of 0 through 74.

Conditional Status

Boards of accountancy may grant conditional status to those candidates who receive a passing grade on some, but not all, sections

taken at one examination administration. Many boards require a minimum grade on the sections failed for the candidate to receive conditional status for the sections passed.

Candidates receiving conditional status generally are allowed a limited number of additional opportunities to pass the remaining sections. If the conditioning credit lapses, the candidate must be reexamined in all sections. Candidates are encouraged to familiarize themselves with the rules and regulations governing the granting of conditional status in their jurisdiction.

Candidate Diagnostic Report

Boards of accountancy may report information to candidates about how they performed on each content area of the examination by including a Candidate Diagnostic Report with the candidates' grades. The report provides information that may be useful to candidates who must retake one or more sections of the examination.

The Candidate Diagnostic Report indicates the percent coverage of each content area for each examination section. It provides the grade for each section taken and indicates the approximate percentage of points the candidate has earned in each content area. Candidates should use caution in interpreting percentages of area earned, especially those that are based on relatively small numbers of questions.

See pages 41 and 42 for a sample Candidate Diagnostic Report and Explanation.

Review Service

Candidates may ask their board of accountancy to submit a request to the AICPA for review of their papers. The AICPA accepts requests beginning on the Uniform Mailing Date (90 days after the examination has been given) through September 20 for the preceding May examination and through March 20 for the preceding November examination.

The AICPA Advisory Grading Service reviews a candidate's paper by manually verifying the accuracy of the objective answer scores; independently verifying the original scoring of essays or problem solutions by a qualified individual who did not participate in the original grading of that paper; and recomputing the total score.

A “no change” is issued to the board of accountancy unless a failing grade is increased to a passing grade or to a minimum grade required on a failed section to retain conditioning credit. Because the Advisory Grading Service subjects papers to very high quality controls throughout all stages of the grading process, reviews rarely result in advisory grade changes. However, if a grade change does occur, all papers with similar characteristics are reviewed for possible grade changes.

Candidates should contact their board of accountancy (see Appendix C) to request a review or for more information.

Uniform CPA Examination — CANDIDATE DIAGNOSTIC REPORT

JURISDICTION		CANDIDATE NUMBER			EXAMINATION DATE					
SECTION	GRADE	CONTENT AREAS AND PERCENT COVERAGE			PERCENTAGE OF AREA EARNED					
					≤ 50	51-60	61-70	71-80	81-90	>90
AUDIT	I	Plan the Engagement	40%							
	II	Obtain and Document Information	35%							
	III	Review the Engagement	5%							
	IV	Prepare Communications	20%							
				100%						
LPR	I	Professional and Legal Responsibilities	15%							
	II	Business Organizations	20%							
	III	Contracts	10%							
	IV	Debtor-Creditor Relationships	10%							
	V	Government Regulation of Business	15%							
	VI	Uniform Commercial Code	20%							
	VII	Property	10%							
			100%							
FARE	I	Concepts and Standards for Financial Statements	20%							
	II	Typical Items in Financial Statements	40%							
	III	Specific Transactions and Events in Financial Statements	40%							
			100%							
ARE	I	Federal Taxation - Individuals	20%							
	II	Federal Taxation - Corporations	20%							
	III	Federal Taxation - Partnerships	10%							
	IV	Federal Taxation - Other	10%							
	V	Governmental and Not-For-Profit Organizations	30%							
	VI	Managerial Accounting	10%							
			100%							

Uniform CPA Examination—Candidate Diagnostic Report

CPA candidates must pass the Uniform CPA Examination to be licensed as certified public accountants in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, and Guam. The Uniform CPA Examination comprises four sections: Auditing (AUDIT), Financial Accounting & Reporting (FARE), Accounting & Reporting—Taxation, Managerial, and Governmental and Not-for-Profit Organizations (ARE), and Business Law & Professional Responsibilities (LPR).

The passing grade for each section is 75. Your **grades** on all **sections** taken during the last Examination session are reported on the reverse side of this page. In addition, there is a summary of your examination performance for the content areas included on each examination section. This summary gives a estimate of how well you did in each of the content areas. For each content area, the summary gives the relative weight (**percent coverage**) assigned to each and the approximate **percentage of area earned**. Candidates should refer to *Information for Uniform CPA Examination Candidates* or *Uniform CPA Examination Candidate Brochure*, each of which gives a complete description of the content areas covered in each section.

Because each board of accountancy establishes its own conditioning requirements, you are encouraged to familiarize yourself with the rules and regulations governing conditional status in your jurisdiction.

How to Use This Report

The content area percentages earned can be valuable to candidates who have passed the various examination sections, as well as to those who have failed. By considering the content area percentages earned for each section, candidates can get an indication of their relative strengths and weaknesses. This information can be helpful to candidates preparing to retake any sections of the Uniform CPA Examination, or in planning their near-term continuing professional education needs. However, caution should be used in interpreting these percentages because they are based on answers to relatively few questions.

Section grades are based on larger numbers of questions than the individual content area percentages. Because of this, total grades provide better representations of a candidate's overall knowledge and skills than the individual content area percentages. If candidates were to take a comparable Uniform CPA Examination *without gaining any new knowledge or skills*, most of their examination grades would fall within five points (up or down) of those earned on this examination. For example, most candidates who received grades of 55 likely would receive grades between 50 and 60 if they took that section again under similar conditions. Additional preparation increases candidates' chances of improving their grades.

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Writing the Examination

Application Forms

Application forms to sit for the Uniform CPA Examination may be obtained from the board of accountancy from which the candidate is seeking a CPA certificate (see Appendix C). Most boards must receive the application at least sixty days before the examination date.

Candidates requiring special accommodations under the Americans With Disabilities Act should contact their board of accountancy for specific guidelines and procedures.

Rules for Examination Day

The Uniform CPA Examination is a closed-book examination. Candidates may bring only pens, No. 2 pencils, and erasers to the examination. Candidates may not bring the following items into the examination room:

- Reference materials
- Calculators, even if ordered from the AICPA Order Department
- Computers
- Other electronic data storage devices
- Communication devices

At the examination site, candidates are given *Examination Question and Answer Booklets* for each section they are taking. In addition, for the Accounting & Reporting—Taxation, Managerial, and Governmental and Not-for-Profit Organizations and Financial Accounting & Reporting sections, candidates are given calculators identified for the specific examination.

The general instructions to candidates are as follows:

1. Prior to the start of the examination, you will be required to sign a *Statement of Confidentiality*, which states:

I hereby attest that I will not divulge the nature or content of any question or answer to any individual or entity, and I will report to the board of accountancy any solicitations and disclosures of which I become aware. I will not remove, or attempt to remove, any Uniform CPA Examination materials, notes, or other unauthorized materials from the examination room. I understand that failure to comply with this attestation may result in invalidation of my grades, disqualification from future examinations, and possible civil and criminal penalties.

2. The only aids you are allowed to take to the examination tables are pens, No. 2 pencils, and erasers.
3. You will receive a Prenumbered Identification Card (or Admission Notice) with your 7-digit candidate number on it. The Prenumbered Identification Card must be available for inspection by the proctors throughout the examination.
4. Any reference during the examination to books or other materials or the exchange of information with other persons shall be considered misconduct sufficient to bar you from further participation in the examination.

Penalties will be imposed on any candidate who is caught cheating before, during, or after the examination. These penalties may include expulsion from the examination, denial of applications for future examinations, and civil or criminal penalties.

5. You must observe the fixed time for each session. It is your responsibility to be ready at the start of the session and to stop writing when told to do so.
6. The following is an example of point values for each question as they might appear in the *Examination Questions* portion of the *Examination Question and Answer Booklet (Booklet)*.

	<u>Point Value</u>
No. 1	60
No. 2	10
No. 3	10
No. 4	10
No. 5	<u>10</u>
Total	<u><u>100</u></u>

When answering each question, you should allocate the total examination time in proportion to the question's point value.

7. The *Booklet* will be distributed shortly before each session begins. Do not break the seal around the *Examination Questions* portion of the *Booklet* until you are told to do so.

Prior to the start of the examination, you are permitted to complete page 1 of the *Booklet* by recording your 7-digit candidate number in the boxes provided in the upper right-hand corner of the page and by filling out and signing the *Attendance Record*. You are also permitted to turn the *Booklet* over and carefully and accurately record your 7-digit candidate number and State on the *Objective Answer Sheet* portion of the *Booklet*.

You must also check the booklet numbers on the *Attendance Record*, *Examination Questions*, *Objective Answer Sheet*, and *Essay Paper*. Notify the proctor if any of these numbers do not match.

You must also review the *Examination Questions* (after you are told to break the seal), *Objective Answer Sheet*, and *Essay Paper* for any possible defects, such as missing pages, blurred printing, or stray marks (*Objective Answer Sheet* only). If any defects are found, request an entirely new *Booklet* from a proctor before you answer any questions.

8. For the Business Law & Professional Responsibilities (LPR), Auditing (AUDIT), and Financial Accounting & Reporting (FARE) sections, your answers to the essay questions or problems must be written on the paper provided in the *Essay Paper* portion of the *Booklet*. After the start of the examination, you should record your 7-digit candidate number, State, and question number on the first page of the *Essay Paper* portion of the *Booklet* and on the other pages where indicated.

9. For the Accounting & Reporting—Taxation, Managerial, and Governmental and Not-for-Profit Organizations (ARE) and FARE examination sections, you will be given a calculator. You should test the calculator in accordance with the instructions on the cover page of the *Booklet*. Inform your proctor if your calculator is defective. Calculators will not be provided for the LPR and AUDIT examination sections because the number of questions requiring calculations is minimal and the calculations are simple.
10. All amounts are to be considered material unless otherwise stated.
11. Answer all objective items on the *Objective Answer Sheet* provided. Use a No. 2 pencil only. You should attempt to answer all objective items, as there is no penalty for incorrect responses. Since the objective items are scanned optically, your comments and calculations associated with them are not considered. You should blacken the ovals as darkly as possible and erase clearly any marks you wish to change. You should make no stray marks.

Approximately 10 to 15 percent of the multiple-choice items are included for pretesting only and are not included in your final grade.

12. It is important to pay strict attention to the manner in which your *Objective Answer Sheet* is structured. As you proceed with the examination, be certain that you blacken the oval that corresponds exactly with the item number in the *Examination Questions* portion of your *Booklet*. If you mark your answers in the *Examination Questions* portion of your *Booklet*, be certain that you transfer them to the *Objective Answer Sheet* before the session ends. Your examination paper will not be graded if you fail to record your answers on the *Objective Answer Sheet*. You will not be given additional time to record your answers.
13. Answer all essay questions and problems on the *Essay Paper* provided. Always begin your answer to a question on the top of a new page, which may be the reverse side of a sheet of paper. Cross out anything that you do not want graded.
14. Selected essay responses will be graded for writing skills.

15. Include all computations to the problems in the FARE section. This may assist the graders in understanding your answers.
16. You may not leave the examination room with any examination materials, nor may you take notes about the examination with you from the examination room. You are required to turn in by the end of each session:
 - a. *Attendance Record and Statement of Confidentiality.*
 - b. *Examination Questions.*
 - c. *Essay Paper* (for LPR, AUDIT, and FARE). Do not remove unused pages.
 - d. *Objective Answer Sheet.*
 - e. Calculator (for ARE and FARE).
 - f. All unused examination materials.
 - g. Prenumbered Identification Card (or Admission Notice) at the last examination section for which you sit (if required by your examining jurisdiction).

Your examination will not be graded unless you hand in these items before you leave the examination room.

17. If you believe one or more questions contain errors and want your concerns evaluated, you must fax your comments to the AICPA (201-938-3443). The fax should include the precise nature of any error, your rationale, and, if possible, references. The fax should include your 7-digit candidate identification number and must be received by the AICPA within 4 days of the completion of the examination administration. This will ensure that all comments are reviewed before the grading bases for the Uniform CPA Examination are confirmed. Although the AICPA cannot respond directly to each fax, it will investigate all comments received within the 4-day period.
18. Contact your board of accountancy for information regarding any other applicable rules.

Objective Answer Sheet

An *Objective Answer Sheet* is provided for each section. You should use Side 1 of the *Objective Answer Sheet* to answer Question 1. The item numbers correspond to the number of items in Question 1 for

that section (e.g. 1–85 for Auditing; 1–66 for LPR). You should use Side 2 to answer the other objective answer format (OOAF) questions. Side 2 is a generic form for all sections that contains space for 65 items. The 65 items are numbered 101 through 165, with 26 answer options (A through Z) for each item.

The *Examination Questions Booklet* contains instructions concerning which items should be answered for each question. Ignore any answer spaces that do not correspond to items in the *Examination Questions Booklet*.

Calculators

Each candidate receives a calculator at the examination site to use on the Accounting & Reporting—Taxation, Managerial, and Governmental and Not-for-Profit Organizations and Financial Accounting & Reporting sections. A candidate may not bring a calculator to the examination site, even if the candidate ordered the calculator from the AICPA.

The purpose of providing calculators is to save the time candidates spend on performing and rechecking manual calculations; it is not intended to allow for more difficult and complex calculations and problems. In other words, the calculations required to answer multiple-choice and problem-type questions are at the same level of complexity as they were before calculators were provided.

Occasionally, candidates are required to perform calculations to answer questions on the Business Law & Professional Responsibilities and Auditing sections. However, since the number of questions requiring calculations is minimal and the calculations are simple, calculators are not provided for either section.

The candidate should only need to use the calculator's four primary functions — add, subtract, multiply, and divide. However, the calculator also has function keys for square root, percentage, and memory. The candidate is given an opportunity to test the calculator to ensure that the calculator is functioning properly by using the test calculations printed in the examination booklets. It is the candidate's responsibility to notify one of the proctors immediately in the event of a malfunction. Replacement calculators are available.

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

- ON** **On and Clear**—Turns the calculator on and clears the display. To clear the calculator of all entries, press **=** then press **ON**.
- 0** ... **9** **Numericals**—Inputs that number.
- .** **Decimal**—Indicates that all numbers to follow are decimals.
- +** & **-** **Add & Subtract**—Adds the next number entered to, or subtracts the next number entered from, the displayed number.
- ×** & **÷** **Multiply & Divide**—Multiplies or divides the displayed number by the next number entered.
- =** **Equal**—Displays the results of all previously entered operations.
- ±** **Change sign**—Changes plus(minus) to minus(plus).
- %** **Percentage**—When performing a calculation, converts the displayed number to a percentage and completes the calculation. It is unlikely that you will need to use this key during the exam.
- √** **Square Root**—Calculates the square root of the displayed number. It is unlikely that you will need to use this key during the exam.
- RCM** **Recall/Clear Memory**—Pressed once, displays the balance in memory. Pressed twice in a row, eliminates the balance in memory but not the displayed number.
- M-** **Memory Subtract**—Subtracts the displayed number from the balance in memory.
- M+** **Memory Add**—Adds the displayed number to the balance in memory.

Test Calculations

Keystroke				Display
ON	53000	+	47600	= 100600
ON	125000	-	98300	= 26700
ON	5000	×	1.667	= 8335
ON	39000	÷	1300	= 30

Appendix A— Information Technology Topics

This appendix lists information technology topics that CPAs need to understand in order to perform auditing and other attestation engagements in computerized environments and provides sample information technology questions.

Role of Information Systems Within Business

Includes reporting concepts and systems, transaction processing systems, management reporting systems, and risks.

Hardware

Includes CPUs, file servers, workstations/terminals, input/output devices, physical storage devices, memory, and communications devices.

Software

Includes operating systems, applications, and security.

Data Structure

Includes file organization, types of data files, and database management systems.

Networks

Includes LANs/WANs/VANs; Internet, intranet, extranet; centralized/decentralized processing; distributed data processing; client/server computing; and end-user computing.

Transaction Processing Modes

Includes batch, on-line, real-time, and distributed processing.

Electronic Commerce

Includes electronic data interchange, electronic fund transfers, point of sale transactions, and Internet-based transactions.

Application Processing Phases

Includes data capture; edit routines; master file maintenance; reporting, accounting, control, and management; query, audit trail, and ad hoc reports; and transaction flow.

IT Control Objectives

Includes completeness, accuracy, validity, integrity, timeliness, and authorization control objectives.

Control Activities and Design

Includes effects of general controls, preventive controls, detective controls, automated controls, and user controls.

Physical Access Controls and Security

Includes user identification, keypad device, and card reader controls; access rights; file attributes; and passwords.

Roles and Responsibilities Within IT Department

Includes roles and responsibilities of database/network/Web administrators, computer operators, librarians, systems programmers, and applications programmers, and appropriate segregation of duties.

Disaster Recovery/Business Continuity

Includes data backup and data recovery procedures, alternate processing facilities (hot sites), and threats and risk management.

Audit Tests of General and Automated Controls

Includes inquiry and observation tests, reperformance tests, parallel simulation tests, embedded audit modules, and test data.

Computer-Assisted Auditing Techniques (CAATs)

Includes feasibility of CAATs; categories of CAATs; available tools/techniques, including data interrogation, extraction, and analysis; definition and design of CAATs; and execution and control of CAATs.

Risks of Auditing Around the Computer (Without Using CAATs)

Includes insufficient paper-based evidence and insufficient audit procedures.

Information Technology Questions

1. Which of the following is considered a component of a local area network?
 - A. Program flowchart.
 - B. Loop verification.
 - C. Transmission media.
 - D. Input routine.

2. Which of the following procedures would an entity most likely include in its computer disaster recovery plan?

- A. Develop an auxiliary power supply to provide uninterrupted electricity.
- B. Store duplicate copies of critical files in a location away from the computer center.
- C. Maintain a listing of all entity passwords with the network manager.
- D. Translate data for storage purposes with a cryptographic secret code.

3. Which of the following would an auditor ordinarily consider the greatest risk regarding an entity's use of electronic data interchange (EDI)?

- A. Authorization of EDI transactions.
- B. Duplication of EDI transmissions.
- C. Improper distribution of EDI transactions.
- D. Elimination of paper documents.

4. Which of the following characteristics distinguishes electronic data interchange (EDI) from other forms of electronic commerce?

- A. The cost of sending EDI transactions using a value-added network (VAN) is less than the cost of using the Internet.
- B. Software maintenance contracts are unnecessary because translation software for EDI transactions need not be updated.
- C. EDI commerce is ordinarily conducted without establishing legally binding contracts between trading partners.
- D. EDI transactions are formatted using strict standards that have been agreed to worldwide.

5. Which of the following represents an additional cost of transmitting business transactions by means of electronic data interchange (EDI) rather than in a traditional paper environment?

- A. Redundant data checks are needed to verify that individual EDI transactions are not recorded twice.
- B. Internal audit work is needed because the potential for random data entry errors is increased.
- C. Translation software is needed to convert transactions from the entity's internal format to a standard EDI format.
- D. More supervisory personnel are needed because the amount of data entry is greater in an EDI system.

6. Many entities use the Internet as a network to transmit electronic data interchange (EDI) transactions. An advantage of using the Internet for electronic commerce rather than a traditional value-added network (VAN) is that the Internet

- A. Permits EDI transactions to be sent to trading partners as transactions occur.
- B. Automatically batches EDI transactions to multiple trading partners.
- C. Possesses superior characteristics regarding disaster recovery.
- D. Converts EDI transactions to a standard format without translation software.

Appendix B—

Sample Examination Questions

The following are samples of multiple-choice, other objective answer format, and essay questions and problems that have appeared on the Uniform CPA Examination but will not be used on future examinations. Sample questions from each section of the examination are included. Circled letters indicate the correct answer.

Auditing

Sample Multiple-Choice Questions

1. Which of the following characteristics most likely would heighten an auditor's concern about the risk of material misstatements in an entity's financial statements?

- A. The entity's industry is experiencing declining customer demand.
- B. Employees who handle cash receipts are **not** bonded.
- C. Bank reconciliations usually include in-transit deposits.
- D. Equipment is often sold at a loss before being fully depreciated.

2. Which of the following fraudulent activities most likely could be perpetrated due to the lack of effective internal controls in the revenue cycle?

- A. Fictitious transactions may be recorded that cause an understatement of revenues and an overstatement of receivables.
- B. Claims received from customers for goods returned may be intentionally recorded in other customers' accounts.
- C. Authorization of credit memos by personnel who receive cash may permit the misappropriation of cash.
- D. The failure to prepare shipping documents may cause an overstatement of inventory balances.

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

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

Sample Other Objective Answer Format

This question consists of 12 items. Select the **best** answer for each item. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Answer all items.** Your grade will be based on the total number of correct answers.

Required:

Items 1 through 12 represent possible errors and fraudulent activities that an auditor suspects are present. The accompanying *List of Auditing Procedures* represents procedures that the auditor would consider performing to gather evidence concerning possible errors and fraudulent activities. For each item, select one or two procedures, as indicated, that the auditor most likely would perform to gather evidence in support of that item. The procedures on the list may be selected once, more than once, or not at all.

Possible Errors and Irregularities

1. The auditor suspects that a kiting scheme exists because an accounting department employee who can issue and record checks seems to be leading an unusually luxurious lifestyle. (Select only 1 procedure)
2. The auditor suspects that the controller wrote several checks and recorded the cash disbursements just before the year end but did not mail the checks until after the first week of the subsequent year. (Select only 1 procedure)
3. The entity borrowed funds from a financial institution. Although the transaction was properly recorded, the auditor suspects that the loan created a lien on the entity's real estate that is not disclosed in its financial statements. (Select only 1 procedure)
4. The auditor discovered an unusually large receivable from one of the entity's new customers. The auditor suspects that the receivable may be fictitious because the auditor has never heard of the customer and because the auditor's initial attempt to confirm the receivable has been ignored by the customer. (Select only 2 procedures)
5. The auditor suspects that fictitious employees have been placed on the payroll by the entity's payroll supervisor, who has access to payroll records and to the paychecks. (Select only 1 procedure)
6. The auditor suspects that selected employees of the entity received unauthorized raises from the entity's payroll supervisor, who has access to payroll records. (Select only 1 procedure)
7. The entity's cash receipts of the first few days of the subsequent year were properly deposited in its general operating account after the year end. However, the auditor suspects that the entity recorded the cash receipts in its books during the last week of the year under audit. (Select only 1 procedure)
8. The auditor suspects that vouchers were prepared and processed by an accounting department employee for merchandise that was neither ordered nor received by the entity. (Select only 1 procedure)
9. The details of invoices for equipment repairs were not clearly identified or explained to the accounting department employees. The auditor suspects that the bookkeeper incorrectly recorded the repairs as fixed assets. (Select only 1 procedure)
10. The auditor suspects that a lapping scheme exists because an accounting department employee who has access to cash receipts also maintains the accounts receivable ledger and refuses to take any vacation or sick days. (Select only 2 procedures)
11. The auditor suspects that the entity is inappropriately increasing the cash reported on its balance sheet by drawing a check on one account and not recording it as an outstanding check on that account, and simultaneously recording it as a deposit in a second account. (Select only 1 procedure)
12. The auditor suspects that the entity's controller has overstated sales and accounts receivable by recording fictitious sales to regular customers in the entity's books. (Select only 2 procedures)

List of Auditing Procedures

- (A) Compare the details of the cash receipts journal entries with the details of the corresponding daily deposit slips.
- (B) Scan the debits to the fixed asset accounts and vouch selected amounts to vendors' invoices and management's authorization.
- (C) Perform analytical procedures that compare documented authorized pay rates to the entity's budget and forecast.
- (D) Obtain the cutoff bank statement and compare the cleared checks to the year-end bank reconciliation.
- (E) Prepare a bank transfer schedule.
- (F) Inspect the entity's deeds to its real estate.
- (G) Make inquiries of the entity's attorney concerning the details of real estate transactions.
- (H) Confirm the terms of borrowing arrangements with the lender.
- (I) Examine selected equipment repair orders and supporting documentation to determine the propriety of the charges.
- (J) Send requests to confirm the entity's accounts receivable on a surprise basis at an interim date.
- (K) Send a second request for confirmation of the receivable to the customer and make inquiries of a reputable credit agency concerning the customer's creditworthiness.
- (L) Examine the entity's shipping documents to verify that the merchandise that produced the receivable was actually sent to the customer.
- (M) Inspect the entity's correspondence files for indications of customer disputes or for evidence that certain shipments were on consignment.
- (N) Perform edit checks of data on the payroll transaction tapes.
- (O) Inspect payroll check endorsements for similar handwriting.
- (P) Observe payroll check distribution on a surprise basis.
- (Q) Vouch data in the payroll register to documented authorized pay rates in the human resources department's files.
- (R) Reconcile the payroll checking account and determine if there were unusual time lags between the issuance and payment of payroll checks.
- (S) Inspect the file of prenumbered vouchers for consecutive numbering and proper approval by an appropriate employee.
- (T) Determine that the details of selected prenumbered vouchers match the related vendors' invoices.
- (U) Examine the supporting purchase orders and receiving reports for selected paid vouchers.

ANSWER

- 1. (E)
- 2. (D)
- 3. (H)
- 4. (K), (L)
- 5. (P)
- 6. (O)
- 7. (A)
- 8. (U)
- 9. (B)
- 10. (A), (J)
- 11. (E)
- 12. (J), (L)

Sample Essay Question

Kent, CPA, is the engagement partner on the financial statement audit of Super Computer Services Co. (SCS) for the year ended April 30, 1998. On May 6, 1998, Smith, the senior auditor assigned to the engagement, had the following conversation with Kent concerning the planning phase of the audit:

Kent: Do you have all the audit programs updated yet for the SCS engagement?

Smith: Mostly. I still have work to do on the fraud risk assessment.

Kent: Why? Our "errors and irregularities" program from last year is still OK. It's passed peer review several times. Besides, we don't have specific duties regarding fraud. If we find it, we'll deal with it then.

Smith: I don't think so. That new CEO, Mint, has almost no salary, mostly bonuses and stock options. Doesn't that concern you?

Kent: No. Mint's employment contract was approved by the Board of Directors just three months ago. It was passed unanimously.

Smith: I guess so, but Mint told those stock analysts that SCS's earnings would increase 30% next year. Can Mint deliver numbers like that?

Kent: Who knows? We're auditing the '98 financial statements, not '99. Mint will probably amend that forecast every month between now and next May.

Smith: Sure, but all this may change our other audit programs.

Kent: No, it won't. The programs are fine as is. If you find fraud in any of your tests, just let me know. Maybe we'll have to extend the tests. Or maybe we'll just report it to the audit committee.

Smith: What would they do? Green is the audit committee's chair, and remember, Green hired Mint. They've been best friends for years. Besides, Mint is calling all the shots now. Brown, the old CEO, is still on the Board, but Brown's never around. Brown's even been skipping the Board meetings. Nobody in management or on the Board would stand up to Mint.

Kent: That's nothing new. Brown was like that years ago. Brown caused frequent disputes with Jones, CPA, the predecessor auditor. Three years ago, Jones told Brown how ineffective the internal audit department was then. Next thing you know, Jones is out and I'm in. Why bother? I'm just as happy that those understaffed internal auditors don't get in our way. Just remember, the bottom line is ... are the financial statements fairly presented? And they always have been. We don't provide any assurances about fraud. That's management's job.

Smith: But what about the lack of segregation of duties in the cash disbursements department? That clerk could write a check for anything.

Kent: Sure. That's a reportable condition every year and probably will be again this year. But we're talking cost-effectiveness here, not fraud. We just have to do lots of testing on cash disbursements and report it again.

Smith: What about the big layoffs coming up next month? It's more than a rumor. Even the employees know it's going to happen, and they're real uptight about it.

Kent: I know, it's the worst kept secret at SCS, but we don't have to consider that now. Even if it happens, it will only improve next year's financial results. Brown should have let these people go years ago. Let's face it, how else can Mint even come close to the 30% earnings increase next year?

Required:

Begin the answer to each requirement (i.e., A, B, and C) on the top of a new page.

A. Describe the fraud risk factors that are indicated in the dialogue above.

B. Describe Kent's misconceptions regarding the consideration of fraud in the audit of SCS's financial statements that are contained in the dialogue above **and** explain why each is a misconception.

C. Describe an auditor's working paper documentation requirements regarding the assessment of the risk of material misstatement due to fraud.

Answer

A. There are many fraud risk factors that are indicated in the dialogue. Among the fraud risk factors are the following:

- A significant portion of Mint's compensation is represented by bonuses and stock options. Although this arrangement has been approved by SCS's Board of Directors, this may be a motivation for Mint, the new CEO, to engage in fraudulent financial reporting.
 - Mint's statement to the stock analysts that SCS's earnings would increase 30% next year may be both an unduly aggressive and unrealistic forecast. That forecast may tempt Mint to intentionally misstate certain ending balances this year that would increase the profitability of the next year.
 - SCS's audit committee may not be sufficiently objective because Green, the chair of the audit committee, hired Mint, the new CEO, and they have been best friends for years.
 - One individual, Mint, appears to dominate management without any compensating controls. Mint seems to be making all the important decisions without any apparent input from other members of management or resistance from the Board of Directors.
 - There were frequent disputes between Brown, the prior CEO, who like Mint apparently dominated management and the Board of Directors, and Jones, the predecessor auditor. This fact may indicate that an environment exists in which management will be reluctant to make any changes that Kent suggests.
 - Management seems to be satisfied with an understaffed and ineffective internal audit department. This situation displays an inappropriate attitude regarding the internal control environment.
 - Management has failed to properly monitor and correct a significant deficiency in its internal control—the lack of segregation of duties in cash disbursements. This disregard for the control environment is also a risk factor.
 - Information about anticipated future layoffs has spread among the employees. This information may cause an increase in the risk of material misstatement arising from the misappropriation of assets by dissatisfied employees.
- B. Kent has many misconceptions regarding the consideration of fraud in the audit of SCS's financial statements that are contained in the dialogue. Among Kent's misconceptions are the following:
- Kent states that an auditor does not have specific duties regarding fraud. In fact, an auditor has a responsibility to specifically assess the risk of material misstatement due to fraud and to consider that assessment in designing the audit procedures to be performed.
 - Kent is not concerned about Mint's employment contract. Kent should be concerned about a CEO's contract that is based primarily on bonuses and stock options because such an arrangement may indicate a motivation for management to engage in fraudulent financial reporting.
 - Kent does not think that Mint's forecast for 1999 has an effect on the financial statement audit for 1998. However, Kent should consider the possibility that Mint may intentionally misstate the 1998 ending balances to increase the reported profit in 1999.
 - Kent believes that the audit programs are fine as is. Actually, Kent should modify the audit programs because of the many risk factors that are present in the SCS audit.
 - Kent is not concerned that the internal audit department is ineffective and understaffed. In fact, Kent should be concerned that SCS has permitted this situation to continue because it represents a risk factor relating to misstatements arising from fraudulent financial reporting and/or the misappropriation of assets.
 - Kent states that an auditor provides no assurances about fraud because that's management's job. In fact, an auditor has a responsibility to plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.
 - Kent is not concerned that the prior year's reportable condition has not been corrected. However, Kent should be concerned that the lack of segregation of duties in the cash disbursements department represents a risk factor relating to misstatements arising from the misappropriation of assets.
 - Kent does not believe that the rumors about big layoffs in the next month have an effect on audit planning. In planning the audit, Kent should consider this risk factor because it may cause an increase in the risk of material misstatement arising from the misappropriation of assets by dissatisfied employees.
- C. In planning a financial statement audit, the auditor should document in the working papers evidence of the performance of the assessment of the risk of material misstatement due to fraud. Where risk factors are identified, the documentation should include those risk factors identified and the auditor's response to those risk factors, individually or in combination. In addition, during the performance of the audit, the auditor may identify fraud risk factors or other conditions that cause the auditor to believe that an additional response is required. The auditor should document such risk factors or other conditions, and any further response that the auditor concludes is appropriate.

Financial Accounting & Reporting

Sample Multiple-Choice Questions

1. For \$50 a month, Rawl Co. visits its customers' premises and performs insect control services. If customers experience problems between regularly scheduled visits, Rawl makes service calls at no additional charge. Instead of paying monthly, customers may pay an annual fee of \$540 in advance. For a customer who pays the annual fee in advance, Rawl should recognize the related revenue

- A. When the cash is collected.
- B. At the end of the fiscal year.
- C. At the end of the contract year after all of the services have been performed.
- D. Evenly over the contract year as the services are performed.

2. Moss Co. has determined its December 31 inventory on a FIFO basis to be \$400,000. Information pertaining to that inventory follows:

Estimated selling price	\$408,000
Estimated cost of disposal	20,000
Normal profit margin	60,000
Current replacement cost	360,000

Moss records losses that result from applying the lower of cost or market rule. At December 31, what should be the net carrying amount of Moss's inventory?

- A. \$400,000
- B. \$388,000
- C. \$360,000
- D. \$328,000

3. A bond issued on June 1, 1998, has interest payment dates of April 1 and October 1. Bond interest expense for the year ended December 31, 1998, is for a period of

- A. Three months.
- B. Four months.
- C. Six months.
- D. Seven months.

Sample Other Objective Answer Format

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

On January 2, 1998, Quo, Inc. hired Reed to be its controller. During the year, Reed, working closely with Quo's president and outside accountants, made changes in accounting policies, corrected several errors dating from 1997 and before, and instituted new accounting policies.

Quo's 1998 financial statements will be presented in comparative form with its 1997 financial statements.

Required:

Items 1 through 10 represent Quo's transactions. List A represents possible classifications of these transactions as: a change in accounting principle, a change in accounting estimate, a correction of an error in previously presented financial statements, or neither an accounting change nor an accounting error.

List B represents the general accounting treatment required for these transactions. These treatments are:

- Cumulative effect approach—Include the cumulative effect of the adjustment resulting from the accounting change or error correction in the 1998 financial statements, and do **not** restate the 1997 financial statements.
- Retroactive restatement approach—Restate the 1997 financial statements and adjust 1997 beginning retained earnings if the error or change affects a period prior to 1997.
- Prospective approach—Report 1998 and future financial statements on the new basis, but do **not** restate 1997 financial statements.

For each item, select one from List A and one from List B and blacken the corresponding ovals on the *Objective Answer Sheet*.

List A (Select one)

- Ⓐ Change in accounting principle.
- Ⓑ Change in accounting estimate.
- Ⓒ Correction of an error in previously presented financial statements.
- Ⓓ Neither an accounting change nor an accounting error.

List B (Select one)

- ⓧ Cumulative effect approach.
- Ⓨ Retroactive restatement approach.
- Ⓩ Prospective approach.

1. Quo manufactures heavy equipment to customer specifications on a contract basis. On the basis that it is preferable, accounting for these long-term contracts was switched from the completed-contract method to the percentage-of-completion method.
2. As a result of a production breakthrough, Quo determined that manufacturing equipment previously depreciated over 15 years should be depreciated over 20 years.
3. The equipment that Quo manufactures is sold with a five-year warranty. Because of a production breakthrough, Quo reduced its computation of warranty costs from 3% of sales to 1% of sales.
4. Quo changed from LIFO to FIFO to account for its finished goods inventory.
5. Quo changed from FIFO to average cost to account for its raw materials and work in process inventories.
6. Quo sells extended service contracts on its products. Because related services are performed over several years, in 1998 Quo changed from the cash method to the accrual method of recognizing income from these service contracts.
7. During 1998, Quo determined that an insurance premium paid and entirely expensed in 1997 was for the period January 1, 1997, through January 1, 1999.
8. Quo changed its method of depreciating office equipment from an accelerated method to the straight-line method to more closely reflect costs in later years.
9. Quo instituted a pension plan for all employees in 1998 and adopted Statement of Financial Accounting Standards No. 87, *Employers' Accounting for Pensions*. Quo had not previously had a pension plan.
10. During 1998, Quo increased its investment in Worth, Inc. from a 10% interest, purchased in 1997, to 30%, and acquired a seat on Worth's board of directors. As a result of its increased investment, Quo changed its method of accounting for investment in subsidiary from the cost method to the equity method.

ANSWER
Financial Accounting & Reporting

	<u>List A</u>	<u>List B</u>
1.	(A)	(Y)
2.	(B)	(Z)
3.	(B)	(Z)
4.	(A)	(Y)
5.	(A)	(X)
6.	(C)	(Y)
7.	(C)	(Y)
8.	(A)	(X)
9.	(D)	(Z)
10.	(D)	(Y)

Sample Essay Question

York Co. sells one product, which it purchases from various suppliers. York's trial balance at December 31 included the following accounts:

Sales (33,000 units @ \$16)	\$528,000
Sales discounts	7,500
Purchases	368,900
Purchase discounts	18,000
Freight-in	5,000
Freight-out	11,000

York Co.'s inventory purchases during the year were as follows:

	<u>Units</u>	<u>Cost per unit</u>	<u>Total cost</u>
Beginning inventory, January 1	8,000	\$8.20	\$ 65,600
Purchases, quarter ended March 31	12,000	8.25	99,000
Purchases, quarter ended June 30	15,000	7.90	118,500
Purchases, quarter ended September 30	13,000	7.50	97,500
Purchases, quarter ended December 31	<u>7,000</u>	7.70	<u>53,900</u>
	<u>55,000</u>		<u>\$434,500</u>

Additional information:

York's accounting policy is to report inventory in its financial statements at the lower of cost or market, applied to total inventory. Cost is determined under the last-in, first-out (LIFO) method.

York has determined that, at December 31, the replacement cost of its inventory was \$8 per unit and the net realizable value was \$8.80 per unit. York's normal profit margin is \$1.05 per unit.

Required:

A. Prepare York's schedule of cost of goods sold, with a supporting schedule of ending inventory. York uses the direct method of reporting losses from market decline of inventory.

B. Explain the rule of lower of cost or market and its application in this situation.

Answer

A.

York Co.
Schedule of Cost of Goods Sold
For the Year Ended December 31

Beginning inventory	\$ 65,600	
Add: Purchases	368,900	
Less: Purchase discounts	(18,000)	
Add: Freight-in	5,000	
Goods available for sale	<u>421,500</u>	
Less: Ending inventory	<u>(176,000)</u>	[1]
Cost of goods sold	<u><u>\$245,500</u></u>	

York Co.
Supporting Schedule of Ending Inventory
December 31

Inventory at cost (LIFO):

	<u>Units</u>	<u>Cost per unit</u>	<u>Total cost</u>
Beginning inventory, January 1	8,000	\$ 8.20	\$ 65,600
Purchases, quarter ended March 31	12,000	8.25	99,000
Purchases, quarter ended June 30	2,000	7.90	15,800
	<u>22,000</u>		<u><u>\$180,400</u></u>

Inventory at market:

22,000 units @ \$8 = \$176,000 [1]

B. Inventory should be valued at the lower of cost or market. Market means current replacement cost, except that:

- (1) Market should not exceed the net realizable value;
and
- (2) Market should not be less than net realizable value reduced by an allowance for an approximately normal profit margin.

In this situation, because replacement cost (\$8 per unit) is less than net realizable value, but greater than net realizable value reduced by a normal profit margin, replacement cost is used as market. Because inventory valued at market (\$176,000) is lower than inventory valued at cost (\$180,400), inventory should be reported in the financial statements at market.

Accounting & Reporting

Sample Multiple-Choice Questions

Taxation

1. Leker exchanged a van that was used exclusively for business and had an adjusted tax basis of \$20,000 for a new van. The new van had a fair market value of \$10,000, and Leker also received \$3,000 in cash. What was Leker's tax basis in the acquired van?

- A. \$20,000
- B. \$17,000
- C. \$13,000
- D. \$ 7,000

Governmental and Not-for-Profit Organizations

2. Governmental financial reporting should provide information to assist users in which situation(s)?

- I. Making social and political decisions.
 - II. Assessing whether current-year citizens received services but shifted part of the payment burden to future-year citizens.
- A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Neither I nor II.

Managerial

3. What is the normal effect on the numbers of cost pools and allocation bases when an activity-based cost (ABC) system replaces a traditional cost system?

- | <u>Cost pools</u> | <u>Allocation bases</u> |
|--|-------------------------|
| A. No effect | No effect |
| B. Increase | No effect |
| C. No effect | Increase |
| <input checked="" type="radio"/> D. Increase | Increase |

Sample Other Objective Answer Format

Taxation

This question consists of 11 items about C corporations. 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.

Capital Corp., an accrual-basis calendar-year C corporation, began operations on January 2, 1998. Capital timely filed its 1998 federal income tax return on Monday, March 15, 1999.

Required:

Items 1 through 4 each require **two** responses:

A. For each item below, determine the amount of Capital's 1998 Schedule M-1 adjustment necessary to reconcile book income to taxable income and select your answer from the list of amounts below. To record your answer, blacken the ovals on the *Objective Answer Sheet*. An amount may be selected once, more than once, or not at all.

<i>Amounts</i>	
Ⓐ \$0	Ⓕ \$ 8,000
Ⓑ \$ 1,000	Ⓖ \$10,000
Ⓒ \$ 5,000	Ⓗ \$15,000
Ⓓ \$ 7,000	Ⓘ \$39,000
Ⓔ \$ 7,500	Ⓙ \$40,000

B. In addition, determine if the Schedule M-1 adjustment necessary to reconcile book income to taxable income increases, decreases, or has no effect on Capital's 1998 taxable income. Blacken the corresponding oval on the *Objective Answer Sheet*. An answer may be selected once, more than once, or not at all.

Selections

- I** Increases Capital's 1998 taxable income.
- D** Decreases Capital's 1998 taxable income.
- N** Has no effect on Capital's 1998 taxable income.

1. At its corporate inception in 1998, Capital incurred and paid \$40,000 in organizational costs for legal fees to draft the corporate charter. Capital correctly elected, for book purposes, to amortize the organizational expenditures over 40 years and for the minimum required period on its federal income tax return. For 1998, Capital amortized \$1,000 of the organizational costs on its books.
 2. Capital's 1998 disbursements included \$10,000 for reimbursed employees' expenses for business meals and entertainment. The reimbursed expenses met the conditions of deductibility and were properly substantiated under an accountable plan. The reimbursement was not treated as employee compensation.
 3. Capital's 1998 disbursements included \$15,000 for life insurance premium expense paid for its executives as part of their taxable compensation. Capital is neither the direct nor the indirect beneficiary of the policy, and the amount of the compensation is reasonable.
 4. In 1998, Capital increased its allowance for uncollectible accounts by \$10,000. No bad debt was written off in 1998.
-

Sunco Corp., an accrual-basis calendar-year C corporation, timely filed its 1998 federal income tax return on Monday, March 15, 1999.

Required:

C. For **Items 5 and 6**, determine if the following items are fully taxable, partially taxable, or nontaxable for regular income tax purposes on Sunco's 1998 federal income tax return. Blacken the corresponding oval on the *Objective Answer Sheet*. An answer may be selected once, more than once, or not at all.

Selections

- Fully taxable for regular income tax purposes on Sunco's 1998 federal income tax return.
- Partially taxable for regular income tax purposes on Sunco's 1998 federal income tax return.
- Nontaxable for regular income tax purposes on Sunco's 1998 federal income tax return.

5. In 1998, Sunco received dividend income from a 35%-owned domestic corporation. The dividends were not from debt-financed portfolio stock, and the taxable income limitation did not apply.
 6. In 1998, Sunco received a \$2,800 lease cancellation payment from a three-year lease tenant.
-

Quest Corp., an accrual-basis calendar-year C corporation, timely filed its 1998 federal income tax return on Monday, March 15, 1999.

Required:

D. For **Items 7 and 8**, determine if the following items are fully deductible, partially deductible, or nondeductible for regular income tax purposes on Quest's 1998 federal income tax return. Blacken the corresponding oval on the *Objective Answer Sheet*. An answer may be selected once, more than once, or not at all.

Selections

- Fully deductible for regular income tax purposes on Quest's 1998 federal income tax return.
- Partially deductible for regular income tax purposes on Quest's 1998 federal income tax return.
- Nondeductible for regular income tax purposes on Quest's 1998 federal income tax return.

7. Quest's 1998 taxable income before charitable contributions and dividends-received deduction was \$200,000. Quest's Board of Directors authorized a \$38,000 contribution to a qualified charity on December 1, 1998. The payment was made on February 2, 1999. All charitable contributions were properly substantiated.
 8. During 1998 Quest was assessed and paid a \$300 uncontested penalty for failure to pay its 1997 federal income taxes on time.
-

On its 1998 federal income tax return, Gelco Corp., an accrual-basis calendar-year C corporation, reported the same amounts for regular income tax and alternative minimum tax purposes.

Required:

E. For **Items 9 through 11**, determine if each item, taken separately, contributes to overstating, understating, or correctly stating Gelco's 1998 alternative minimum taxable income (AMTI) prior to the adjusted current earnings adjustment (ACE). Blacken the corresponding oval on the *Objective Answer Sheet*. An answer may be selected once, more than once, or not at all.

Selections

- Overstating Gelco's 1998 AMTI prior to the ACE.
- Understating Gelco's 1998 AMTI prior to the ACE.
- Correctly stating Gelco's 1998 AMTI prior to the ACE.

- 9.** For regular tax purposes, Gelco deducted the maximum MACRS depreciation on seven-year personal property placed in service on January 1, 1998. Gelco made no Internal Revenue Code Section 179 election to expense the property in 1998.
- 10.** For regular income tax purposes, Gelco depreciated non-residential real property placed in service on January 1, 1998, under the general MACRS depreciation system for a 39-year depreciable life.
- 11.** Gelco excluded state highway construction general obligation bond interest income earned in 1998 for regular income tax and alternative minimum tax (AMT) purposes.

ANSWER
Taxation

	A	B
1.	Ⓓ	Ⓓ
2.	Ⓒ	Ⓘ
3.	Ⓐ	Ⓝ
4.	Ⓒ	Ⓘ
	C	
5.	Ⓕ	
6.	Ⓕ	
	D	
7.	Ⓕ	
8.	Ⓝ	
	E	
9.	Ⓐ	
10.	Ⓐ	
11.	Ⓒ	

Governmental and Not-for-Profit Organizations

This question consists of 3 parts concerning nongovernmental not-for-profit organizations. Part A consists of 4 items, Part B consists of 7 items, and Part C consists of 8 items. Select the **best** answer for each item. Use a No. 2 pencil to blacken the appropriate ovals on the *Objective Answer Sheet* to indicate your answers. **Answer all items.** Your grade will be based on the total number of correct answers.

A. Items 1 through 4 are based on the following:

Community Service, Inc. is a nongovernmental not-for-profit voluntary health and welfare calendar-year organization that began operations on January 1, 1997. It performs voluntary services and derives its revenue primarily from voluntary contributions from the general public. Community implies a time restriction on all promises to contribute cash in future periods. However, no such policy exists with respect to gifts of long-lived assets.

Selected transactions that occurred during Community's 1998 calendar year:

- Unrestricted written promises to contribute cash—1997 and 1998—1997 promises (collected in 1998) \$22,000
—1998 promises (collected in 1998) 95,000
—1998 promises (uncollected) 28,000
- Written promises to contribute cash restricted to use for community college scholarships—1997 and 1998—1997 promises (collected and expended in 1998) 10,000
—1998 promises (collected and expended in 1998) 20,000
—1998 promises (uncollected) 12,000
- Written promise to contribute \$25,000 if matching funds are raised for the capital campaign during 1998—Cash received in 1998 from contributor as a good faith advance 25,000
—Matching funds received in 1998 0
- Cash received in 1997 with donor's only stipulation that a bus be purchased—Expenditure of full amount of donation 7/1/98 37,000

Required:

Items 1 through 4 represent the 1998 amounts that Community reported for selected financial statement elements in its December 31, 1998, statement of financial position and 1998 statement of activities. For each item, indicate whether the amount was overstated, understated, or correctly stated. Select your answer from the list below and blacken the corresponding oval on the *Objective Answer Sheet*. An answer may be selected once, more than once, or not at all.

<i>List</i>	
Ⓐ	Overstated.
Ⓑ	Understated.
Ⓒ	Correctly stated.

1. Community reported \$28,000 as contributions receivable.
2. Community reported \$37,000 as net assets released from restrictions (satisfaction of use restrictions).
3. Community reported \$22,000 as net assets released from restrictions (due to the lapse of time restrictions).
4. Community reported \$97,000 as contributions—temporarily restricted.

B. Items 5 through 11 are based on the following:

Community Service, Inc. is a nongovernmental not-for-profit voluntary health and welfare calendar-year organization that began operations on January 1, 1997. It performs voluntary services and derives its revenue primarily from voluntary contributions from the general public. Community implies a time restriction on all promises to contribute cash in future periods. However, no such policy exists with respect to gifts of long-lived assets.

Selected transactions that occurred during Community's 1998 calendar year:

- Debt security endowment received in 1998; income to be used for community services
 - Face value \$90,000
 - Fair value at time of receipt 88,000
 - Fair value at 12/31/98 87,000
 - Interest earned in 1998 9,000

- 10 concerned citizens volunteered to serve meals to the homeless (400 hrs. free; fair market value of services \$5 per hr.) 2,000
- Short-term investment in equity securities in 1998
 - Cost 10,000
 - Fair value 12/31/98 12,000
 - Dividend income 1,000
- Music festival to raise funds for a local hospital
 - Admission fees 5,000
 - Sales of food and drinks 14,000
 - Expenses 4,000
- Reading materials donated to Community and distributed to the children in 1998
 - Fair market value 8,000
- Federal youth training fee for service grant
 - Cash received during 1998 30,000
 - Instructor salaries paid 26,000
- Other cash operating expenses
 - Business manager salary 60,000
 - General bookkeeper salary 40,000
 - Director of community activities salary 50,000
 - Space rental (75% for community activities, 25% for office activities) 20,000
 - Printing and mailing costs for pledge cards 2,000
- Interest payment on short-term bank loan in 1998 1,000
- Principal payment on short-term bank loan in 1998 20,000

Required:

For **Items 5 through 11**, determine the amounts for the following financial statement elements in the 1998 statement of activities. Select your answer from the following list of amounts and blacken the corresponding oval on the *Objective Answer Sheet*. An amount may be selected once, more than once, or not at all.

Amounts		
(A) \$0	(F) \$ 9,000	(K) \$87,000
(B) \$ 2,000	(G) \$14,000	(L) \$88,000
(C) \$ 3,000	(H) \$16,000	(M) \$90,000
(D) \$ 5,000	(I) \$26,000	(N) \$94,000
(E) \$ 8,000	(J) \$50,000	(O) \$99,000

- 5. Contributions—permanently restricted.
- 6. Revenues—fees.
- 7. Investment income—debt securities.

- 8. Program expenses.
- 9. General fund-raising expenses (excludes special events).
- 10. Income on long-term investments—unrestricted.
- 11. Contributed voluntary services.

C. Items 12 through 19 are based on the fact pattern and financial information found in **both Part A and Part B**.

Required:

Items 12 through 19 represent Community's transactions reportable in the statement of cash flows. For each of the items listed, select the classification that best describes the item, and blacken the corresponding oval on the *Objective Answer Sheet*. A classification may be selected once, more than once, or not at all.

Classifications
<input type="radio"/> Cash flows from operating activities.
<input type="radio"/> Cash flows from investing activities.
<input type="radio"/> Cash flows from financing activities.

- 12. Unrestricted 1997 promises collected.
- 13. Cash received from a contributor as a good faith advance on a promise to contribute matching funds.
- 14. Purchase of bus.
- 15. Principal payment on short-term bank loan.
- 16. Purchase of equity securities.
- 17. Dividend income earned on equity securities.
- 18. Interest payment on short-term bank loan.
- 19. Interest earned on endowment.

ANSWER
Governmental and Not-for-Profit Organizations

- A**
- 1. Ⓐ
 - 2. Ⓐ
 - 3. Ⓒ
 - 4. Ⓒ

- B**
- 5. Ⓒ
 - 6. Ⓓ
 - 7. Ⓔ
 - 8. Ⓒ
 - 9. Ⓑ
 - 10. Ⓐ
 - 11. Ⓐ

- C**
- 12. Ⓒ
 - 13. Ⓒ
 - 14. Ⓘ
 - 15. Ⓕ
 - 16. Ⓘ
 - 17. Ⓒ
 - 18. Ⓒ
 - 19. Ⓒ

Business Law & Professional Responsibilities

Sample Multiple-Choice Questions

1. According to the profession's ethical standards, an auditor would be considered independent in which of the following instances?

- A. The auditor is the officially appointed stock transfer agent of a client.
- B. The auditor's checking account, which is fully insured by a federal agency, is held at a client financial institution.
- C. The client owes the auditor fees for more than two years prior to the issuance of the audit report.
- D. The client is the only tenant in a commercial building owned by the auditor.

2. Which of the following rights is a holder of a public corporation's cumulative preferred stock always entitled to?

- A. Conversion of the preferred stock into common stock.
- B. Voting rights.
- C. Dividend carryovers from years in which dividends were not paid to future years.
- D. Guaranteed dividends.

3. Under the Sales Article of the UCC, the remedies available to a seller when a buyer breaches a contract for the sale of goods may include

	<u>The right to resell goods identified to the contract</u>	<u>The right to stop a carrier from delivering the goods</u>
<input checked="" type="radio"/> A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

Sample Other Objective Answer Format Question

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

On April 15, 1998, Wren Corp., an appliance wholesaler, was petitioned involuntarily into bankruptcy under the liquidation provisions of Chapter 7 of the Federal Bankruptcy Code.

When the petition was filed, Wren's creditors included:

<u>Secured creditors</u>	<u>Amount owed</u>
Fifth Bank—1st mortgage on warehouse owned by Wren	\$50,000
Hart Manufacturing Corp.—perfected purchase money security interest in inventory	30,000
TVN Computers, Inc.—perfected security interest in office computers	15,000
<u>Unsecured creditors</u>	<u>Amount owed</u>
IRS—1996 federal income taxes	\$20,000
Acme Office Cleaners—services for January, February, and March 1998	750
Ted Smith (employee)—February and March 1998 wages	2,400
Joan Sims (employee)—March 1998 commissions	1,500
Power Electric Co.—electricity charges for January, February, and March 1998	600
Soft Office Supplies—supplies purchased in 1997	2,000

All of Wren's assets were liquidated. The warehouse was sold for \$75,000, the computers were sold for \$12,000, and the inventory was sold for \$25,000. After paying the bankruptcy administration expenses of \$8,000, secured creditors, and priority general creditors, there was enough cash to pay each nonpriority general creditor 50 cents on the dollar.

Required:

A. Items 1 through 5 represent creditor claims against the bankruptcy estate. Select from List I each creditor's order of payment in relation to the other creditors named in **Items 1 through 5** and blacken the corresponding oval on the *Objective Answer Sheet*.

1. Bankruptcy administration expense.
2. Acme Office Cleaners.
3. Fifth Bank.
4. IRS.
5. Joan Sims.

<i>List I</i>	
(A) First.	(D) Fourth.
(B) Second.	(E) Fifth.
(C) Third.	

B. Items 6 through 10 also represent creditor claims against the bankruptcy estate. For each of the creditors listed in **Items 6 through 10**, select from List II the amount that creditor will receive and blacken the corresponding oval on the *Objective Answer Sheet*.

6. TVN Computers, Inc.
7. Hart Manufacturing Corp.
8. Ted Smith.
9. Power Electric Co.
10. Soft Office Supplies.

<i>List II</i>		
(A) \$0	(F) \$ 2,000	(K) \$15,000
(B) \$ 300	(G) \$ 2,200	(L) \$25,000
(C) \$ 600	(H) \$ 2,400	(M) \$27,500
(D) \$ 1,000	(I) \$12,000	(N) \$30,000
(E) \$ 1,200	(J) \$13,500	

ANSWER
Business Law & Professional Responsibilities

- 1. A
- 2. B
- 3. E
- 4. A
- 5. D

- 6. C
- 7. B
- 8. J
- 9. M
- 10. H

Sample Essay Question

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

On May 4, 1998, 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, 1998. Under the terms of the original lease, Bridge was obligated to pay all utility costs. On May 5, 1998, 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, 1998, 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, 1998; and an acceptance must be received by Dart to be effective. On June 9, 1998, 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, 1998.

On June 22, 1998, 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, 1998, 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.

Appendix C—

Boards of Accountancy

For information on how to become a Certified Public Accountant (CPA) and how to apply to take the Uniform CPA Examination, you should contact the board of accountancy in the jurisdiction in which you wish to obtain the CPA certificate. This directory is current as of April 20, 2000.

ALABAMA STATE BOARD OF PUBLIC ACCOUNTANCY

RSA Plaza, Suite 236
770 Washington Avenue
Montgomery, AL 36130-0375
Attn: J. Lamar Harris, CPA
Executive Director
Tel: 334-242-5700
Fax: 334-242-2711

ALASKA STATE BOARD OF PUBLIC ACCOUNTANCY

Dept. of Commerce and Economic
Development
Division of Occupational Licensing
P.O. Box 110806
Juneau, AK 99811-0806
Attn: Steven B. Snyder
Licensing Examiner
Tel: 907-465-2580
Fax: 907-465-2974
E-mail: license@dced.state.ak.us
Web Site:
www.dced.state.ak.us/occ/pcpa.htm

ARIZONA STATE BOARD OF ACCOUNTANCY

3877 North Seventh Street, Suite 106
Phoenix, AZ 85014
Attn: Ruth R. Lee
Executive Director
Tel: 602-255-3648
Fax: 602-255-1283
E-mail: info@mail.accountancy.state.az.us
Web Site: www.accountancy.state.az.us

ARKANSAS STATE BOARD OF PUBLIC ACCOUNTANCY

101 East Capitol, Suite 430
Little Rock, AR 72201
Attn: James E. George, CPA
Executive Director
Tel: 501-682-1520
Fax: 501-682-5538
Web Site: www.state.ar.us/asbpa

CALIFORNIA STATE BOARD OF ACCOUNTANCY

2000 Evergreen Street, Suite 250
Sacramento, CA 95815-3832
Attn: Carol B. Sigmann
Executive Officer
Tel: 916-263-3680
Fax: 916-263-3675
E-mail: examinfo@cba.ca.gov
Web Site: www.dca.ca.gov/cba

COLORADO STATE BOARD OF ACCOUNTANCY

1560 Broadway, Suite 13470
Denver, CO 80202
Attn: Bob Longway
Administrator
Tel: 303-894-7800
Fax: 303-894-7802
E-mail: accountants@dora.state.co.us
Web Site:
www.dora.state.co.us/accountants

CONNECTICUT STATE BOARD OF ACCOUNTANCY

Secretary of State
30 Trinity Street, P.O. Box 150470
Hartford, CT 06106
Attn: David Guay
Executive Director
Tel: 860-509-6179
Fax: 860-509-6247
Web Site:
www.sots.state.ct.us/sboa/sboaindex.html

DELAWARE STATE BOARD OF ACCOUNTANCY

Cannon Building, Suite 203
P.O. Box 1401
Dover, DE 19903
Attn: Mary Paskey
Administrative Assistant
Tel: 302-739-4522
Fax: 302-739-2711
E-mail: mpaskey@state.de.us

DISTRICT OF COLUMBIA BOARD OF ACCOUNTANCY

Dept. of Consumer & Reg. Aff., Rm. 7200
941 North Capital Street, N.E., 7th Fl.
Washington, DC 20002
Attn: Harriette Andrews
Administrator
Tel: 202-442-4461
Fax: 202-442-4528
Web Site: www.dkra.org

FLORIDA BOARD OF ACCOUNTANCY

2610 N.W. 43rd Street, Suite 1A
Gainesville, FL 32606-4599
Attn: Martha P. Willis
Division Director
Tel: 352-955-2165
Fax: 352-955-2164
E-mail: aboard@mail.dbpr.state.fl.us
Web Site: www.state.fl.us/dbpr/html/cpa

GEORGIA STATE BOARD OF ACCOUNTANCY

237 Coliseum Drive
Macon, GA 31217-3858
Attn: Barbara Kitchens
Executive Director
Tel: 912-207-1400
Fax: 912-207-1410
Web Site: www.sos.state.ga.us/edb-accountancy/default.htm

GUAM BOARD OF ACCOUNTANCY

P.O. Box 5753
Hagatna, GU 96932
Attn: Lisa A. Leon Guerrero
Administrative Director
Tel: 671-735-2559
Fax: 671-734-3461

HAWAII BOARD OF PUBLIC ACCOUNTANCY

Dept. Commerce & Consumer Affairs
P.O. Box 3469
Honolulu, HI 96801-3469
Attn: Laureen Kai
Executive Officer
Tel: 808-586-2696
Fax: 808-586-2689

IDAHO STATE BOARD OF ACCOUNTANCY

P.O. Box 83720
Boise, ID 83720-0002
Attn: Barbara R. Porter
Executive Director
Tel: 208-334-2490
Fax: 208-334-2615
E-mail: isba@boa.state.id.us
Web Site: www.state.id.us/boa

ILLINOIS BOARD OF EXAMINERS

505 E. Green, Room 216
Champaign, IL 61820-5723
Attn: Joanne Vician
Executive Director
Tel: 217-333-1565
Fax: 217-333-3126
Web Site: www.illinois-cpa-exam.com

**ILLINOIS PUBLIC ACCOUNTANTS
REGISTRATION COMMITTEE**

Public Accountancy Section
320 W. Washington Street, 3rd Floor
Springfield, IL 62786-0001
Attn: Daniel Harden
Board Liaison
Tel: 217-785-0800
Fax: 217-782-7645

INDIANA BOARD OF ACCOUNTANCY

In. Prof. Lic. Agc., In. Gov. Ctr. S.
302 West Washington St., Rm. E034
Indianapolis, IN 46204-2246
Attn: Nancy Smith
Exam Coordinator
Tel: 317-232-5987
Fax: 317-232-2312
Web Site: [www.state.in.us/pla/
accountancy/index.html](http://www.state.in.us/pla/accountancy/index.html)

**IOWA ACCOUNTANCY EXAMINING
BOARD**

1918 S.E. Hulsizer Avenue
Ankeny, IA 50021-3941
Attn: William M. Schroeder
Executive Secretary
Tel: 515-281-4126
Fax: 515-281-7411
E-mail: IACC@max.state.ia.us
Web Site: [www.state.ia.us/government/
com/prof/acct](http://www.state.ia.us/government/com/prof/acct)

KANSAS BOARD OF ACCOUNTANCY

Landon State Office Building
900 S.W. Jackson Street, Suite 556
Topeka, KS 66612-1239
Attn: Susan L. Somers
Executive Director
Tel: 785-296-2162
Fax: 785-291-3501
E-mail: ksboa@ink.org
Web Site: www.ink.org/public/ksboa

**KENTUCKY STATE BOARD
OF ACCOUNTANCY**

332 West Broadway, Suite 310
Louisville, KY 40202-2115
Attn: Susan G. Stopher
Executive Director
Tel: 502-595-3037
Fax: 502-595-4281
Web Site: www.state.ky.us/agencies/boa

STATE BOARD OF CPAs OF LOUISIANA

Pan-American Life Center
601 Poydras Street, Suite 1770
New Orleans, LA 70139
Attn: Michael A. Henderson, CPA
Executive Director
Tel: 504-566-1244
Fax: 504-566-1252

MAINE BOARD OF ACCOUNTANCY

Dept. of Prof. & Fin. Reg., Office of Lic.
& Reg.
#35 State House Station
Augusta, ME 04333-0035
Attn: Cheryl Hersom
Board Administrator
Tel: 207-624-8627
Fax: 207-624-8637
Web Site: [www.state.me.us/pfr/led/
account/index.htm](http://www.state.me.us/pfr/led/account/index.htm)

MARYLAND STATE BOARD OF PUBLIC ACCOUNTANCY

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Web Site: www.cpaboard.wa.gov

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The Candidate Kit includes the following three study aids: *Uniform CPA Examination Selected Questions & Unofficial Answers Indexed to Content Specification Outlines*, Uniform CPA Examination Calculator, and *Information for Uniform CPA Examination Candidates*, 16th Edition.

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The unofficial answers have been prepared by the staff and reviewed by the AICPA Board of Examiners. A summary of coverage for the May 1996 through May 1998 examinations has also been included. The summary lists the total number of questions by section, content specification outline, and format.

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