

12-1-2004

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## Recommended Citation

Edelstein, Peter M., "Classroom Warfare—AICPA and AACSB vs. Legal Studies: Result: The New CPA Exam" (2004). *Faculty Working Papers*. Paper 38.  
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# WORKING PAPERS

No. 213      December 2004

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LEGAL STUDIES  
RESULT: THE NEW CPA EXAM**

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## **ABSTRACT**

The American Institute of Certified Public Accountants (AICPA) and the Association to Advance Collegiate Schools of Business (AACSB International) either intentionally or because of shortsightedness or ignorance have diminished the importance of the study of law. By choosing to ignore the news headlines and the illegal and unethical behavior of some executives, these organizations fail to realize the connection between a knowledge of the law and the quality of business leaders. The marginalization of legal studies ill-serves our students. The new computerized CPA Exam is the latest manifestation of this trend.

## **INTRODUCTION**

If ever there was a period in history in which one could say that a fundamental knowledge of law is a practical necessity, it is now. All variety of laws, rules, and regulations are ubiquitous and intrusive in our daily life. Ask any small business owner who seeks a license or even any homeowner who wants to refinance.

A basic knowledge of the law is not a luxury, but a necessity, not only to successfully navigate the maze of a free economy, but to maintain an ethical and moral society—one in which the sanctity of rules is respected.

### **THE DEATH OF THE STUDY OF BAILMENTS**

The subject of bailments is an ancient area of the law and still represents one of the most common transactions. <sup>1</sup> It is manageable in scope and rewarding to study.

- Bailments combine contract law and tort law, and serve to refresh the student in both areas, which is especially important if contracts and torts were studied in a previous or introductory law course. <sup>2</sup>
- Bailments serve as an excellent vehicle for explaining and illustrating the difference between real and personal property (“goods,” under the UCC)<sup>3</sup>—a difference that is meaningful in virtually all commercial law courses.
- Bailments introduce and distinguish the concepts of title and possession that are the foundation for learning Documents of Title, Transfer of Title, Risk of Loss, Personal Property, Insurance, Real Property, and even Trusts and Estates. <sup>4</sup>
- Bailments raise the issue of ethics and pose an ethical dilemma. Is it fair that a person, separated from his or her property, and thus unaware of what may have happened to it, should have the burden of proving that the defendant was negligent? <sup>5</sup>
- Bailments explain and illustrate the function of a legal “presumption,” that operates as a “plaintiff’s helper,” by shifting the burden of proof to the defendant to show the absence of negligence. <sup>6</sup>
- Bailments serve as the link between Law 101, and its basic and introductory content, and subsequent law courses with content that may focus on transactional concepts.

Under the new Uniform CPA Examination, which became effective in April of this year, bailments, among other subjects, is no longer covered. The great loss is not that future CPAs will not know what a bailment is, but that they will be deprived of such a valuable learning exercise.

### **THE AICPA JUST DOESN'T GET IT**

The AICPA, in justifying its changes to the substance of the CPA Exam, stated its objective:

“To keep pace with the evolution of the accounting profession and the business world...and to provide ongoing protection of the public interest...[To] help insure that CPA candidates continue to demonstrate *the knowledge and skill needed to protect the public*”<sup>7</sup> (emphasis added).

In as few words as possible, the author would merely suggest that the accounting profession review the following case studies, among many others:

- ENRON
- WorldCom
- Arthur Anderson
- Adelphia
- Xerox
- Global Crossing
- Merrill Lynch
- Quest<sup>8</sup>
- Martha Stewart<sup>9</sup>

It would be presumptuous to assume that if the executives of the companies listed were familiar with the applicable laws, the respective scandals would not have occurred. But in view of the common theme of the oft-repeated defenses amounting to: “I didn’t know,” it seems that the marginalization of law by the accounting profession is misguided.

### **THE AACSB DOESN'T GET IT EITHER**

The AACSB International<sup>10</sup> is an accrediting organization from which many business schools covet recognition. It was founded in 1916 and first set standards for business schools in 1919.<sup>11</sup>

The AACSB International<sup>12</sup> publishes a document entitled “Eligibility Procedures and Standards for Business Accreditation”<sup>13</sup> that states in its Introduction:

“...the Association to Advance Collegiate Schools of Business promotes continuous quality improvements in management education.”<sup>14</sup> Thereafter, the Standards include a section entitled “Standards for Business Accreditation”<sup>15</sup> that includes the heading “Assurance of Learning Standards, Management of Curricula,” which requires:

“...an undergraduate degree program that includes learning experiences in such general knowledge and such areas as:

- Communication abilities
- Ethical understanding and reasoning abilities
- Analytical skills
- Use of information technology
- Multicultural and diversity understanding
- Reflective thinking skills.”<sup>16</sup>

If ever there was a single area of study that satisfied the AACSB accreditation standards, it is the study of law. Addressing their requirements in sequence:

- ***Communication Abilities.*** The study of law includes writing briefs, use of the Socratic method of discourse in the classroom, exams with essay questions, and homework problems requiring written answers.
- ***Ethical Understanding and Reasoning Abilities.*** The study of the law is the study of social values, morals, and ethics. From the basic query: is it fair that a promise made without consideration not be enforced? To the philosophical: should an agreement, in all other respects enforceable, not be enforced because it is unconscionable?
- ***Analytical Skills.*** There is an old pronouncement heard in law school: “The study of law teaches you how to think.” The process of briefing a case is a standard and consistent methodology used to analyze the facts, determine the issues to be decided, apply the applicable law, and arrive at a logical conclusion.
- ***Use of Information Technology.*** Many readers of this paper may be too young to remember going to the law library in law school. Searching for a case. Hoping the volume was in the stacks. Praying that some overly eager and competitive classmate had not ripped it out of the book. By some miracle finding the case. Searching for nickels for

the copy machine. Crossing your fingers that the copy machine was working. And so on. Today, our students have access to those miracles of technology, LexisNexis<sup>17</sup> and the Internet. In a fraction of a second, cases, statutes, public information, and news items can be in our students' hands. The study of law has adapted to I.T. like it was designed for it.

- ***Multicultural and Diversity Understanding.*** *Brown v. Board of Education*,<sup>18</sup> *Rowe v. Wade*,<sup>19</sup> and thousands of other cases represent real people, actual emotions, decisions that shaped the world as we know it today. What other business subject can offer such a passionate understanding of how we evolved as a society?
- ***Reflective Thinking Skills.*** What is the study of law if not a medium for reflective thinking? Is a case decision good law? Is the result fair and equitable? Can the law ever be unethical? Can an unethical act ever be legal? Briefing cases justifies and defends a decision. Studying the brief explains the legal reasoning. Comparing briefs distinguishes cases.

It is submitted not only that the study of the law is a necessary part of the education of every CPA and every manager, but that legal studies should be embraced by the AACSB as the ideal subject area. Yet, the AACSB doesn't seem to recognize this.

Professor Fran Zollers in her article in the Spring 2004 issue of the ALSB Newsletter,<sup>20</sup> reports on the latest AACSB standards decision. While it may not be a cosmic change, the J.D. degree has been relegated to a separate category at the bottom of the list of "academically qualified faculty possessing a doctoral degree in the area in which the individual teaches...."

This issue arises just after the near elimination, but successful struggle to retain law and ethics in the AACSB standards.<sup>21</sup> While the J.D. issue is still not resolved, the recurrent problems are continuing evidence of their total lack of appreciation of and respect for the study of law.



## THE NEW COMPUTER-BASED UNIFORM CPA EXAMINATION

The historic paper-based exam that extended over 15 ½ hours and contained parts addressing *Business Law and Professional Responsibilities*, *Accounting and Reporting*, *Auditing*, and *Financial Accounting and Reporting* is no more. *Business Law* as a separate part has been eliminated.

The AICPA,<sup>22</sup> the National Association of State Boards of Accounting (NASBA),<sup>23</sup> and a private company, Prometric,<sup>24</sup> collaborated to design and administer the new exam. The changes were the result of a 2002 AICPA “practice analysis” survey to which hundreds of CPA’s responded by identifying the most important requirements for future CPA’s.<sup>25</sup>

The new exam will still have four sections: *Auditing & Attestation* (4.5 hours), *Financial Accounting & Reporting* (4 hours), *Regulations* (3 hours), and *Business Environment & Concepts* (2.5 hours).<sup>26</sup>

The new test will be offered year-round at Prometric facilities and State Board testing facilities<sup>27</sup> in a format that will consist of multiple choice questions and case-studies (“simulations”). The simulations will require the student to do computer-based research.<sup>28</sup> The test will be offered up to six days a week in two of every three months, instead of only twice a year like the old test.<sup>29</sup>

The new form and schedule will probably appeal to those CPA candidates who are computer literate or wish to break the testing process into smaller parts. They can now take the exam up to four times a year and can take each part separately.<sup>30</sup>

It is, however, the content of the revised exam, rather than the form, that further relegates the law to a lower status.

A new section, entitled *Business Environment & Concepts* includes coverage of business structures (17-34%),<sup>31</sup> economics, financial management, information technology, and planning and measurement.<sup>32</sup> In addition to the new section, law teachers must now focus on another section of the exam that also tests law subjects: the *Regulation* part. According to the AICPA, the *Regulation* section will examine, among other topics, professional and legal responsibility, business law, and the skills needed to apply that knowledge.<sup>33</sup> The general breakdown is *Ethics and Professional Responsibilities* (15-20%), and *Business Law* (20-25%).<sup>34</sup>

The AICPA describes the *Regulation* section as follows:

“The [section] tests candidates’ knowledge of federal taxation, ethics, professional and legal responsibilities, and *business law* and the skills necessary to apply that knowledge.”<sup>35</sup>

Under the heading *Business Law*, the following topics are tested:

A. Agency

1. Formation and termination
2. Duties and authority of agents and principals
3. Liabilities and authority of agents and principals

B. Contracts

1. Formation
2. Performance
3. Third-party assignments
4. Discharge, breach, and remedies

C. Debtor-creditor relationships

1. Rights, duties, and liabilities of debtors, creditors, and guarantors
2. Bankruptcy

D. Government Regulation of Business

1. Federal Securities Act
2. Other government regulations (antitrust, pension and retirement plans, union and employee relations, and legal liability for payroll and social security taxes)

E. Uniform Commercial Code

1. Negotiable instruments and letters of credit
2. Sales
3. Secured transactions
4. Documents of title and title transfer

F. Real property, including insurance<sup>36</sup>

The new *Business Environment & Concepts* section is described as follows:

“...[the] section tests knowledge of general business environment and business concepts that candidates need to know in order to understand the underlying business reasons for and accounting implications of transactions, and the skills needed to apply that knowledge in performing financial statement audit and attestation engagements and other functions normally performed by CPAs

that affect the public interest. Content covered in this section includes knowledge of business structure; economic concepts essential to obtaining an understanding of an entity's operations, business and industry; financial management; information technology; and planning and measurement."<sup>37</sup>

The law-specific topics are:

Business Structures (17%-23%)

- A. Advantages, implications, and constraints of legal structures for business
  - 1) Sole proprietorships and general limited partnerships
  - 2) Limited liability companies (LLC), limited liability partnerships (LLP), and joint ventures
  - 3) Subchapter C and subchapter S corporations
- B. Formation, operation, and termination of business
- C. Financial structure, capitalization, profit and loss allocation, and distributions
- D. Rights, duties, legal obligations, and authority of owners and management (directors, officers, stockholders, partners, and other owners).<sup>38</sup>

The AICPA has published a more detailed "Content Specification" for the new *Business and Environment Concepts* section.<sup>39</sup> A copy is attached as Appendix "A."

## **VI. WHAT TO TEACH?**

If our classes contain CPA candidates, we have a responsibility to teach, address, or at least warn them about the CPA exam content coverage. To those in class who are not CPA candidates, the CPA Exam required subjects may be somewhat esoteric but not out of the realm of useful knowledge.

For those with a CPA-centric focus, the changes now require coverage of:

- Letters of Credit
- Pension and Retirement Plans
- Social Security Taxes

The Exam no longer requires coverage of:

- Personal property
- Bailments
- Computer technology rights
- Estates and trusts
- Environmental regulation

### **WHY DO WE TEACH LAW?**

The author retains the notion that teaching law helps make our students better people. Our teaching involves more than creating automatons that can parrot rules. We should seek to create a passion for what is right, fair, and ethical.

It is respectfully submitted that we should:

- Teach that law is what allows us to live in harmony
- Teach the meaning of right and wrong in a society that has seemingly embraced a relativist viewpoint of the meaning of good and bad
- Teach that legal decisions must not be viewed independently from ethical considerations
- Teach respect for all people
- Teach respect for other peoples' property
- Teach the rules of law

We live in a world in which every college student, whether in business school or not, should be taught and should learn the fundamentals of law. We should teach more law, not less.

**EXHIBIT A**

**Business Environment and Concepts**

**II. Detail for Content Specification Outline**

**Area I- Business Structures(17%-23%)**

Group A- Advantages, implications and constraints of legal structures for business

A CPA examination candidate should be able to:

- Identify the general characteristics of various business forms such as sole proprietorship, partnership (general, limited, limited liability), joint venture, limited liability company, and corporation( Subchapter C, Subchapter S).
- Identify the advantages and disadvantages of various business forms such as sole proprietorship, partnership, (general, limited, limited liability), joint venture, limited liability company, and corporation( Subchapter C, Subchapter S).

Group B- Formation, operation, termination of businesses

The candidate should be able to:

- Determine the recommended business form based on given facts and circumstances.
- Identify circumstances indicating when a business should be terminated.
- List the factors supporting a fiscal rather than a calendar year for both financial reporting and federal taxation purposes.

Group C- Financial structure, capitalization, profit and loss allocation, and distributions

The candidate should be able to:

- Determine income available for distribution
- Allocate profits and losses for distribution to owners
- Identify the characteristics, rights and implications of various capitalization options

Group D- Rights, duties, legal obligations, and authority of owners and management

The candidate should be able to:

- Differentiate between the rights, duties and legal obligations, and authority of owners (shareholders and partners) and management(directors, officers, and management)
  - In general terms
  - Based on business form

## ENDNOTES

1. Richard A. Mann and Barry S. Roberts, eds., *Smith and Roberson's Business Law*, 12<sup>th</sup> ed. Pacific Grove, CA: West Pub. Co., 2002:p. 969.
2. Ibid, pp. 970-971.
3. Ibid., p. 970.
4. Ibid., p. 973.
5. Ibid., pp 13-21.
6. Ibid., p. 971.
7. Gregory Johnson, *The Journal of Accountancy*, September 2003.  
[http://www.findarticles.com/cf\\_dls/m6280/3\\_196/08600254/print.jhtml](http://www.findarticles.com/cf_dls/m6280/3_196/08600254/print.jhtml)
8. See: "Wall Street Scandals at a Glance," BBC News  
<http://bbc.co.uk/1/hi/business/2066962.stm>, 26 June 2002 and "Wall Street Scandals at a Glance," BBC News  
<http://bbc.co.uk/1/hi/business/2158557.stm>, 12 February 2003
9. See any media outlet July 16, 2004.
10. The Association to Advance Collegiate Schools of Business.
11. See: Eligibility Procedures and Standards for Business Accreditation, Adopted: April 25, 2003, Revised: January 01, 2004.
12. Ibid., p. 3.
13. Ibid.
14. Ibid., p. 3.
15. Ibid., p. 16.
16. Ibid., p. 18.
17. LexisNexis is a trademark of Reed Elsevier plc.
18. *Brown v. Board of Education*, 347U.S. 483, 74S.CT.686, 98L.ED.873 (1954)
19. *Rowe v. Wade*, 410 U.S.113, 93S.CT.705, 358L.ED.2d147 (1973)
20. *ALSB Newsletter*, The Publication of the American Business Law Association, Inc.
21. *Id.*
22. AICPA, the American Institute of Certified Public Accountants, is the national, professional organization of the CPAs, with more than 330,000 members. It sets U.S. Auditing standards and professional ethical standards, and with the Financial Accounting Standard Board, U.S. Accounting standards. See: *Business Wire*, Inc., Computerized CPA Exam Tutorial available: covers form and functions, May 12, 2003.
23. The National Association of State Boards of Accounting serves as a forum for 54 member boards in the U.S., Puerto Rico, Guam, Virgin Islands, and Washington, D.C. See: Press Release, Thomson Prometric,  
<http://www.prometric.com.PressRoom/cpaexams.htm>.
24. Prometric, a part of Thomson Corp. (NYSE: TOC, TSX: TOC)
25. See: Adam Snyder, *Journal of Accounting*, October 2003,  
[http://www.findarticles.com/cf\\_dls/m6250/4\\_196/10889621/p1/article...](http://www.findarticles.com/cf_dls/m6250/4_196/10889621/p1/article...)
26. See: Gregory Johnson, *Journal of Accounting*, September 2003;  
[http://www.findarticles.com/cf\\_dls/m6280/3\\_196/108600254/print.jhtml](http://www.findarticles.com/cf_dls/m6280/3_196/108600254/print.jhtml)
27. Ibid.

28. Ibid.
29. See: Adam Snyder, *Journal of Accounting*, October 2003;  
[http://www.findarticles.com/cf\\_dls/m6280/4\\_196/108839621/p1/article...](http://www.findarticles.com/cf_dls/m6280/4_196/108839621/p1/article...)
30. See: Adam Snyder, *Journal of Accounting*, December 2003;  
[http://www.findarticles.com/cf\\_dls/m6280/6\\_196/111533005/print.jhtml](http://www.findarticles.com/cf_dls/m6280/6_196/111533005/print.jhtml)
31. See: Diane Babuin, *Journal of Accounting*, November 2003;  
[http://www.findarticles.com/cf\\_dls/m6280/5\\_196/110461832/print.jhtml](http://www.findarticles.com/cf_dls/m6280/5_196/110461832/print.jhtml)
32. See: Board of Examiners of the AICPA, Uniform CPA Examination Content Specifications, June 14, 2002.
33. Ibid., p. 11.
34. Ibid.
35. Ibid.
36. Ibid., p. 12.
37. Ibid., p. 15.
38. Ibid.
39. See: AICPA Business Environment and Concepts. Additional Detail Corresponding to Content Specification Outline, dated June 14, 2002. Board of Examiners of the AICPA, October 10, 2003.