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To: State Boards of Accountancy
From: Gary L. Fish, Chair Task Force on National Examination
Preparedness for the Illinois Board of Examiners
Date: July 7, 2008
Re: Replies to Sam Cotterell's Questions

At the conclusion of NASBA's Conference on the State of the Examination which was held on May 19th at the Grand Hyatt DFW, Mr. Cotterell summarized the day by requesting input on five questions. (See page one of the June issue of the *NASBA State Board Report*.) We believe that these are excellent questions and are hopeful that each SBA will take the time to respond. Our responses are attached to this document and we look forward to receiving yours.

While many key issues were identified and discussed, we were disappointed that the conference did not speak to the issue of the 120 vs. 150 hour educational requirement. Had the conference had an adequate focus on this issue, we believe the question of what skills the exam is and should be testing would have surfaced. If, going forward, the CBT CPA exam is going to focus only on knowledge testing, the 120 hour education requirement might be appropriate. However, if, as we believe it should, the focus of the exam is moved beyond low level knowledge testing and continues to move in the direction of higher level professional skills testing, then the 150 education requirement would be more appropriate. The anticipated adoption of IFRS for US public companies and the related increase in testing of IFRS on the CPA exam will make the 150 hour requirement even more appropriate. IFRS are more principled based than current US GAAP and will consequently require more judgment and analysis to apply. The additional 30 hours of education would provide candidates with the opportunity to develop these skills. As the profession continues to become more complex we believe that the higher level skills testing will be required to protect the public interest. (See the section entitled, "Proposed Skills Specifications

Outlines” in the recently released Proposed Content and Skills Specifications for the Uniform CPA Examination 2008 – Exposure Draft, pp. 38-41.)

The previous paragraph is based on the following assumptions: The typical undergraduate accounting curriculum (i.e. 120 hours) has a main focus on teaching knowledge and basic problem solving. The typical masters accounting curriculum (i.e. 150 hours) has as its main focus teaching the professional skills of analysis, judgment, synthesis and research. A student must be well grounded in professional knowledge and problem solving in order to apply the professional skills. In other words, in an undergraduate program a student does a lot of memory work and problem solving. In a master’s program a student does substantially more communicating (both in writing and speaking) about accounting issues which requires a substantial amount of judgment, analysis and evaluation.

The Illinois Board of Examiners is in favor of leaving the educational requirement at 150 hours to qualify to test.

Additional question: Should the CBT CPA exam continue to move in the direction of more professional skills testing?

The newest auditing standards require auditor evaluation of risk of misstatement or fraud. This shifts the auditor's focus from the completion of check lists to the utilization of more auditor judgment and documentation of processes and controls. Once an auditor exercises judgment he/she will also be required to document how the decision was reached.

Documenting the-processes, controls and *decisions in writing requires a higher level of professional skill, again, better tested by "skills testing" than "knowledge testing". This, too, makes a strong case to continue to support writing skills to be tested on the CBT CPA exam.*

Contract: What changes should be made to the exam contract as we go forward?

Any changes to the exam contract should be based on a systematic review of the existing relationships among the main parties. Noel Allen covered the agreement broadly, identifying key provisions and obligations of the current contract, as well as potential enhancements of a future contract. A NASBA Task Force should be formed to elaborate on the key issues that are the most problematic. Once identified, the key issues should be prioritized and then vetted with the SBAs. The highest priority items with strong support and wide agreement from the SBAs should be the main focus of NASBA's effort to obtain contract changes. Obviously, since NASBA is only one party (although representing many voices) to a three party contract, it is not assured that all the changes that might be desired will be obtained.

Cost: It is an irrefutable fact that costs of the exam are increasing. What can or should be done to change that?

While costs may be constantly rising, it is important to attempt to identify the sources of the largest amount of the increases. While the SBAs do not have access to the cost data, it would appear that the majority of the increases in fees occurred due to amortization of startup research and development (R&D) costs as opposed to increases in operating expenses. This is not to say that operating expenses have not increased; they have. However, we believe the vast majority of the increases have been driven by R&D costs related to the development of skills testing in the simulations.

While exact figures are not available to SBAs, it is reasonable to assume that the majority of the cost of developing the CPA CBT Exam has been driven by the cost of developing and scoring simulations. One of the major objectives of simulations is "skills testing". At the time of the conversion from P&P to CBT one of the biggest criticisms of the P&P exam was that it was too "knowledge based" (i.e. multiple choice questions) and not sufficiently "skills based" (Problems, Cases, Essays, Research). The AICPA's Board of Examiners funded several skills based research projects in order to develop the current exam. This type of cutting edge research, while expensive, contributes to the CBT CPA Exam being considered one of the premier national "high stakes" professional exams.

Going forward, each proposed fee increase should be divided into at least two components – operating expense increase and R&D costs. Before a major R&D project is implemented, both NASBA and the AICPA should review the written proposal. Consensus should be obtained that the proposed improvement(s) are appropriate and that the benefits exceed the costs.

It is our belief that for the CPA CBT Exam to maintain its status as one of the premier high stakes professional exams, the effort to move beyond knowledge testing (i.e. M-CQ) to skill testing is mandatory. However, the contractual arrangements that allowed the current level of unamortized R&D costs of \$44 million to be accumulated must be modified. The profession should guard against this happening again without a consensus of all the major stakeholders being in agreement that such a major investment is prudent.

Exhibit A (see attached) summarizes and condenses a PPT slide from Joe Cote's presentation. Joe's slide summarizes the costs charged by the three vendors (AICPA, Prometric & NASBA). The overall cost of the CBT Exam is expected to nearly double (i.e. from \$470 to \$923) in the development years from 2004 to 2010. The increase in total fees is estimated to be \$453. Of this amount \$294 or 65% of the increase is attributable to the AIPCA. Exhibit A indicates that any significant cost controls must focus on the AICPA.

Control: Should state board control of the exam be enhanced? If so, how?

SBA's control over the exam might need to be enhanced. However, the increase in control should be based on a carefully prepared analysis which identifies those aspects of the exam process that are required for the SBAs to fulfill their responsibility to protect the public interest. We are not convinced that development of the CPA exam by an organization other than the AICPA would reduce the cost or the problems that CBT has encountered since its implementation.

Since a study has not been done to determine what processes the SBAs want more control over, the issue is open to speculation. We believe that the cost of the exam is one of these issues. As stated in other answers, we believe that future major innovations on the exam, which may be very expensive, should be open to more negotiation between the AICPA and

NASBA. Currently, the AICPA develops the CBT Exam and sells it to NASBA based on the costs incurred. The AICPA should seek more input from the SBAs to determine how much innovation cost the candidates can bear. In other words, the SBAs need more upfront control over the R&D costs that become part of the AICPA fee.

Contingency: Do the potential contingencies identified and the benefits of having a contingency exam warrant the costs of developing such an exam?

None of the scenarios that Dan Dustin presented in his PPT entitled, “Possible Scenarios that Might Result in the Need for a Contingency Examination” appear to be urgent. While all the scenarios are possible, none appear to be likely or probable to occur in the foreseeable future. There has never been the need for a contingency exam in the recent history of the CPA exam which raises the question “why now?”.

What complicates this question is that no cost estimates were presented which makes it very difficult to compare the benefits and costs of developing a contingency exam. The cost of a contingency exam would probably consist of two components. The first is the cost of developing the framework for the contingency exam. The framework could probably be used for all four sections of the contingency exam with minor modifications. Once the framework was in place, there would be additional huge expenses to constantly update the test items on a timely basis to reflect the constantly changing professional standards. It is our opinion that a strong case has not been established for needing a contingency exam. Nor have sufficient cost figures been provided to SBAs to make a reasonable and informed decision.

International Delivery: Two models are being considered related to the international delivery of the exam. These are issuance of a certificate and/or letter of completion or establishment of a new credential. What are your thoughts on these two models?

At this time, it is our opinion that the International CBT CPA Exam should be state based. The successful candidates should receive a CPA certificate and/or a letter of completion from individual State Boards of Accountancy, which currently are the only entities authorized by statute to issue CPA certificates and licenses.

We will consider supporting the credential model under the control of a joint NASBA/AICPA committee after a proposal has been developed and vetted to the SBAs.

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Any comments can be directed to me at garyfish@ilstu.edu or Ms. Joanne Vician, Executive Director, Illinois Board of Examiners at jvician@illinois.edu

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Sample Total Candidate Fees for Four Sections
Condensed from Joe Cote's PPT Slide

<u>Year</u>	<u>AICPA</u>	<u>Prometric</u>	<u>NASBA</u>	<u>Total</u>
2004	\$ 180.00	\$ 250.00	\$ 40.00	\$ 470.00
2010	<u>\$ 474.00</u>	<u>\$ 369.00</u>	<u>\$ 80.00</u>	<u>\$ 923.00</u>
Dollar Increase	\$ 294.00	\$ 119.00	\$ 40.00	\$ 453.00
Per cent Increase by Vendor	163%	48%	100%	96%
Per Cent Increase of the Total	65%	26%	9%	