

# **NINJA CPA Review®**



## **NINJA Notes**

Financial Accounting & Reporting

# FAR

Source: AICPA

Content Area		Allocation
Area I	Conceptual Framework, Standard-Setting and Financial Reporting	25-35%
Area II	Select Financial Statements Accounts	30-40%
Area III	Select Transactions	20-30%
Area IV	State and Local Governments	5-15%

## Skill Levels

Evaluation	The examination or assessment of problems, and use of judgment to draw conclusions.
Analysis	The examination and study of the interrelationships of separate areas in order to identify causes and find evidence to support inferences.
Application	The use or demonstration of knowledge, concepts or techniques.
Remembering and Understanding	The perception and comprehension of the significance of an area utilizing knowledge gained.

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# How to use NINJA Notes

## Reading

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**Carry it with you wherever you go.**

Simply load the PDF onto your mobile device, and **if you have 5 minutes of downtime, you have 5 minutes of study time.**

It is recommended that you read the NINJA Notes at least **five times** leading up to your final two weeks of exam prep.

If you have 6 weeks to study, then you need to complete this in 4 weeks. 5 weeks to study, then complete it in 3. 4 weeks = 2 weeks. You get the picture. The point is: plan, plan, plan and budget, budget, budget, budget because exam day is looming.

### Learning Plans

#### 6-Week Plan

- Approx. 122 pages x 5 reads
- 4 weeks
- 7 days per week = Approx. 22 pages per day

#### 5-Week Plan

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Forget the old way. **You are a NINJA now.**



Now is the time to either:

1. Rewrite your own CPA Exam notes or
2. Rewrite the NINJA Notes.

Plan on investing a week doing this, and you should expect to get through at least 20 pages a day to stay on track.

# VIII. Governmental Accounting

## Governmental Accounting Basics

- Primary Objective
  - Provide information that is useful and benefits a wide range of users including
    - Cost of Services provided
    - Sufficiency of Revenues to cover costs
    - Financial Position of the Entity
- GAAP Hierarchy for State & Local Governments
  - Authoritative
    - Category A
      - GASB Statements
    - Category B
      - GASB Technical Bulletins
      - GASB Implementation Guides
      - GASB-Approved AICPA Literature
  - Non-Authoritative
    - GASB Concepts Statements
    - FASB Pronouncements / Other
- Fund Types
  - Governmental Funds

- Proprietary Funds
- Fiduciary Funds
- Fund Accounting – Two Types
  - Accrual Basis
    - Current Economic Resources Focus
    - Revenues recognized when earned
  - Modified Accrual Basis
    - Current Financial Resources Focus
    - Revenues recognized when available & measurable
- Budget Estimates
  - Appropriation
    - Highest amount allowed for an expenditure
  - Encumbrance
    - Records purchases & reserves it
- Budget Actuals
  - Expenditure
    - The actual cost of something
- Opening Budgetary Entry

Dr Estimated Revenues Control

Cr Appropriations Control

Dr/Cr Budgetary Fund Balance (plug)

- Closing Budgetary Entry

Dr Appropriations Control

Dr/Cr Budgetary Fund Balance (plug)

Cr Estimated Revenues Control



# Governmental Funds (GSP-CD)

- Use Modified Basis of Accounting
- Have a Current Financial Resource Focus
- Revenue Recognized when available and measurable
  - Sales tax revenue to be received within 60 days of the fiscal year-end that will be used to fund expenditures made prior to year-end are treated as revenue in the current fiscal year
- **General Fund**
  - The “Operating” fund of the governmental unit
    - Records Significant Revenues
      - Taxes
      - Tickets
      - Fines
      - Licenses
    - Records Significant Expenditures
      - Police
      - Education
      - Fire Dept.
- **Special Revenue Fund**
  - Restricted for a specific purpose such as street repair
- **Permanent Fund**
  - Legally restricted

- Only earnings can be used to fund programs
- Principal remains intact
- **Capital Projects Fund**
  - Used to acquire and build facilities
- **Debt Service Fund**
  - Handles repayment of long-term debt and related interest
- **Governmental Fund Balance Types**
  - Restricted – Restricted by Contributor (Strict)
  - Committed – Restricted by Government (Less strict because they can undo the restriction)
  - Assigned – Intended to be used for a purpose
  - Unassigned – Available to be spent
  - Non-Spendable – isn't in a "spendable" state (Inventory)
- **Governmental Fund Statements**
  - Balance Sheet
  - Statement of Revenues, Expenditures, and Changes in Fund Balance
- **Revenue Recognition**
  - Is it available?
  - Is it measurable?
  - If yes – it's revenue, regardless of when it is spent
- **Derived Tax Revenue**

- Collected by people “doing” things
  - Buying cars
    - Sales Tax
  - Going to work
    - Income Tax
- Imposed Tax Revenue
  - Assessed just because things “exist”
    - Property Tax on car
      - Your car could sit in the driveway all year and never move. The fact that it exists means it gets taxed
    - Real Estate Tax
  - Recorded as Revenue when *Budgeted*

## Proprietary Funds

- Use Accrual Basis of Accounting
  - Orientation is Income Determination
- Have an Economic Resource Focus
- Revenue Recognized when earned and measurable
- Internal Service Fund
  - Serves the needs of other governmental units
  - Example: Motor Pool fixes government vehicles
- Enterprise Fund

- Provides goods or services to external users
- Example: Post Office
- Proprietary Fund Financial Statements
  - Statement of Net Position
  - Statement of Revenues, Expenses, and Changes in Net Assets
  - Statement of Cash Flows

## **Fiduciary Funds**

- Use Accrual Basis of Accounting
- Have an Economic Resource Focus
- **Custodial Fund**
  - Government acts as a custodian
- **Pension Trust Fund**
  - Government is a trustee for a pension plan
- **Investment Trust Fund**
  - Government is trustee over a series of investments
- **Private Purpose Trust**
  - Trust that benefits various individuals and entities
- Fiduciary Fund Financial Statements
  - Statement of Fiduciary Net Position
  - Statement of Changes in Fiduciary Net Position

# Investment & Liability Valuation

- Fair Value
  - Price received to sell an Investment
    - Held for Income or Profit
  - Price paid to transfer a liability
- Valuation Approaches
  - Market Approach
    - Price from similar transactions
  - Cost Approach
    - Price to replace similar asset
  - Income Approach
    - Converts future cash flows to current amounts
    - Example: Present Value Technique
- Fair Value Hierarchy
  - Level 1 (Best)
    - Quoted Prices for Same Assets & Liabilities
  - Level 2
    - Quoted Prices for Similar Assets & Liabilities
  - Level 3
    - Best Data Available
- Acquisition Value
  - Price paid if purchased instead of donated

- Donated Assets
- Donated Art
- Investment & Liability Disclosures
  - Organized by Asset & Liability Type or Class
  - Fair Value Measurement
    - Valuation Technique
      - Change in Valuation Technique?
    - Level of FV Hierarchy used

## **Government-Wide Financial Statements**

- Statement of Net Position & Statement of Activities
  - Prepared on an Accrual Basis
  - Focus is on Economic Measurement
  - Purpose is to provide Operational Accountability
- Statement of Net Position
  - Assets (Current & Non-Current)
    - Ordered by Liquidity
  - Deferred Outflows of Resources
    - Future use of Net Assets
    - Exam Tip – Which MCQ option is an example of cash leaving the entity?

- Exam Tip – D. Outflows follow Assets in presentation (Assets – Outflows – Liabilities – Inflows) because it's going to use those assets.
- Liabilities (Current & Non-Current)
  - Ordered by Liquidity
- Deferred Inflows of Resources
  - Future increase in Net Assets
  - Exam Tip – Which MCQ option is an example of cash entering the entity?
  - Exam Tip – D. Inflows follows Liabilities in presentation ... think of it as bringing in money (Inflow) and now you owe a service
- Restricted Net Assets
- Unrestricted Net Assets
- Divided into
  - Government Activities
  - Business Activities
- Capital Assets are shown Net of Debt
  - NEW: Interest Costs incurred before the end of the construction period are now expensed as incurred
    - Intended to enhance the usefulness of the financial statements by showing the cost of borrowing vs capitalizing and including it with the asset cost and amortizing over time

Asset Cost

- Accumulated Depreciation
- Asset Liabilities

Net Assets

- Infrastructure
  - Modified Approach
    - Reported at Cost
    - No Accumulated Depreciation
- Statement of Activities
  - Government activities divided by function
  - Revenues
    - General Revenues
    - Program Revenues
- Notes to Financial Statements
  - Notes are considered part of Financial Statements
- Presentation
  - If the activities of a component are distinguishable from the rest of the governmental entity, then **Discrete Presentation** is required
  - If the activities of the component cannot be identified and separated from the rest of the governmental activities, then **Blended Presentation** is warranted.
  - Component units are reported in the Entity-Wide Financial Statements and not the Fund Financial Statements.



# Defined Benefit Pension Plans

- Financial Statements Required
  - Statement of Fiduciary Net Position
    - Assets
    - Deferred Outflows
    - Liabilities
    - Deferred Inflows
    - Fiduciary Net Position
  - Statement of Changes in Fiduciary Net Position
    - Additions
      - Contributions
      - Net Investment Income
    - Deductions
      - Benefit Payments
      - Admin Expense
    - Net Change in Fiduciary Net Position
- Financial Statement Notes
  - Types of Benefits Provided
  - Plan Member Classes
  - Board of Directors Information
  - Investments
    - Policies
    - Fair Value Determination

# Leases (GASB 87)

- Lease Classifications
  - Short-Term Lease
  - Contracts Transferring Ownership
  - Other Leases
- Lease Term
  - Period of time that Lessee has non-cancelable right to use Leased Asset
  - Add: Extension Option if exercise is expected
  - Minus: Cancel Option if exercise is expected
- Short-Term Lease
  - Lease term doesn't exceed 12 months
  - Accounted for like an Operating Lease with lease term less than 12 Months
  - Lessee Accounting
    - Recognize Rent Expenditure
  - Lessor Accounting
    - Recognize Rent Revenue
- Contracts Transferring Ownership
  - Accounted for like a FASB Sales-Type Lease
  - Lessee Accounting
    - Accounted for as a Financed Purchase
    - Non-Current Asset

- Proprietary & Fiduciary Funds
  - Recognizes Lease Liability
  - Expenditure–Capital Outlay
    - Governmental Funds
    - Other Financing Source
- Lessor Accounting
  - Recognizes Lease Receivable
    - Governmental Funds
    - Proprietary Funds
    - Fiduciary Funds
  - Recognizes Deferred Inflow of Resources/Revenue
    - Governmental Funds
  - De–recognizes Non–Current Asset
    - Proprietary & Fiduciary Funds
- Other Leases
  - All Leases that are not Short–Term or Transferring Ownership
  - Accounted for like a FASB Direct Finance Lease
  - Lessee Accounting
    - Accounted for as a Financed Purchase
    - Right–of–Use Asset
      - Proprietary & Fiduciary Funds
    - Expenditure–Capital Outlay
      - Governmental Funds

- Recognizes Lease Liability
  - Proprietary & Fiduciary Funds
- Other Financing Source
  - Governmental Funds
- Lessor Accounting
  - Recognizes Lease Receivable & Deferred Inflow of Resources/Revenue
    - Governmental Funds
    - Proprietary Funds
    - Fiduciary Funds Funds

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**[Think you're ready for FAR? Let's find out:](#)**



**83% Of Current CPA Candidates  
Cannot Pass This Simple Quiz.**

Discover How Prepared You Really Are.

A blue rectangular interface for selecting a quiz section. At the top, it says "Choose the section for your quiz". Below this are four radio button options: "AUD", "BEC", "FAR", and "REG". The "FAR" option is selected. Below the options is a large orange button with the text "Start Quiz".

Choose the section for your quiz \*

AUD  BEC  FAR  REG

Start Quiz

# NINJA CPA Review®



## NINJA Notes

Auditing & Attestation

# AUD

Source: AICPA

Content Area		Allocation
Area I	Ethics, Professional Responsibilities, and General Principles	15-25%
Area II	Assessing Risk and Developing a Planned Response	25-35%
Area III	Performing Further Procedures and Obtaining Evidence	30-40%
Area IV	Forming Conclusions and Reporting	10-20%

## Skill Levels

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# VI. Audit Sampling

- Audit Sampling is taking part of a population, subjecting it to audit procedures, projecting results to a population
  - Example – You have 100 gumballs and you test the quality of 10 of them and make an inference about the entire bag of gumballs based on the 10 that you sampled
- Statistical Sampling
  - Based on formulas
  - Helps find an appropriate audit sample
  - Helps evaluate evidence obtained
  - Evaluate results and quantifies Sampling Risk
- Non-Statistical Sampling
  - Based on a human decision
  - Equally acceptable as Statistical Sampling
- Substantive Tests
  - Variables Sampling
  - Probability Proportionate to Size Sampling
- Control Tests
  - Attribute Sampling

# Sampling Risk

- Sampling Risk is the risk that your sample isn't representative of population
  - Can happen even if audit is done properly
  - Example – You sample 10 gumballs out of 100 and conclude that the bag of gumballs is acceptable for sale to your customers, when in fact the other 90 are inedible
- Risk of Assessing Control Risk Too High
  - A risk of Control Testing where the sample overstates Control Risk
  - Auditor works to make Control Risk lower
    - Does more substantive testing
  - Leads to an under-reliance on Internal Control, over-testing, and overall *Audit Inefficiency*
    - Audit ends up being effective (correct result), but the auditor does more work than necessary
- Risk of Assessing Control Risk Too Low
  - A risk of Control Testing where the sample *understates* Control Risk
    - This error leads to over-reliance on Internal Control, under-testing, and overall *Audit Ineffectiveness*
  - Inverse relationship to Sample Size
    - Higher accepted risk of assessing Control Risk too low = Smaller Sample

- Lower accepted risk of assessing Control Risk too low =  
Larger Sample
  - Leads to higher Detection Risk
    - Recap: Detection Risk is the risk that the auditor will fail to detect a material misstatement
    - Auditor does fewer Substantive Tests
  - Does NOT necessarily mean that the Financial Statements are materially misstated –
    - However, it does mean that if there is one, the auditor is less likely to find it
- Incorrect Acceptance
  - A risk of Substantive Testing
  - Auditor accepts a balance as fairly stated, when in fact it is not fairly stated
    - Hurts audit effectiveness
    - Wrong conclusion reached
    - Efficient, but not effective
- Incorrect Rejection
  - A risk of Substantive Testing
  - Auditor rejects balance as fairly stated when in fact it *is* fairly stated
    - Hurts audit efficiency
    - Wrong recommendations given
    - Effective, but not efficient
- Non-Sampling Risk

- Risk of human (Auditor) missing an error
  - Synonyms: Exception, Error, & Deviation
- Sampling vs. Non-Sampling Risk
  - Sampling Risk deals with the chance that your audit *sample* is flawed
  - Non-Sampling risk deals with the chance that your *human decisions/conclusions* are flawed

## Attribute Sampling

- Looking at Control Procedures
  - Were invoices approved when paid?
- Errors are stated in terms of %, not dollar amount
  - 5 invoices out of 100 were not properly paid
    - Error Rate is 5%
    - If you see “error rate” on the CPA Exam, they are referring to Attribute Sampling
- Control Procedures are either operating properly or they are not operating properly – based on Error Rate and the tolerance you have for errors
- Tolerable Rate
  - Error rate in population that you are willing to accept/tolerate
  - Inverse relationship to Sample Size
    - Higher Tolerable Rate = Smaller Sample
    - Lower Tolerable Rate = Larger Sample

- If you're willing to accept a higher probability that errors exist, there is less pressure on the sample
  - Expected Population Error Rate
    - What Error Rate are you expecting?
      - Judgment call for Auditor
      - Based on Auditor's experience
    - Direct relationship to Sample Size
      - More errors = Larger Sample
      - Less errors = Smaller Sample
- Attribute in the sample gives information about the entire audit population
- Used to estimate Internal Control error rate
- Expected Population Deviation (error) Rate
  - Used to determine initial level of Control Risk
- Allowable Risk of Over-reliance
  - Risk of Assessing Control Risk Too Low
  - Gives you the Sampling Risk
- Attribute sampling is only useful when there is documented evidence (an audit trail) to test
- Use when the *existence of an error* needs to be verified or debunked

# Classic Variables Sampling

- Testing for a dollar amount
- Value in sample gives information about value in entire population
- Mean Per Unit
  - Sample Average x Number in Population
- Stratification
  - Similar transactions are grouped together (>\$1M and <\$1M) and then subjected to audit procedures
  - Decreases effect of variance in population and reduces sample size

# Probability Proportionate To Size (PPS)

- A form of Variable Sampling
- Does NOT use Standard Deviation
- Auditor focuses on a dollar amount
- Larger or more valuable items get picked more often as part of the sample
- Projected Misstatement
  - Misstatement found in sample – Auditor must project it to remainder of population



## Classic Variables Sampling vs PPS

- Classic Variables Sampling
  - Easy to expand sample size
  - Selecting zero and negative balances easy
- PPS
  - Easier to use
  - Results in a stratified (homogenous) sample
  - Results in a smaller sample size to audit
  - Easy to design

## Factors That Affect Sample Size

- Tolerable Rate for Error
  - *Inverse* relationship with Sample Size
- Risk of assessing Control Risk too low
  - *Inverse* relationship with Sample Size
- Expected Population Error Rate
  - *Direct* relationship with Sample Size
- Population size does NOT affect the sample size
  - As population grows larger, sample size doesn't grow with it

# Formula For Audit Sampling

- $SER + ASR < TER$
- Sample Error Rate (SER)
  - 5 out of 100 invoices were not approved correctly
  - Sample Error Rate = 5%
- Allowance for Sampling Risk (ASR)
  - The amount that you add to the Sample Error Rate (SER) to get some cushion for your sample
  - Allow for as high as you think the population error rate could go based on experience
  - ASR is set at 2%, based on judgment
  - Population error rate could reach 7% (5+2)
- Tolerable Error Rate (TER)
  - Error rate auditor is willing to accept
  - If population error rate  $< TER$ 
    - Accept the Control as effective
  - If population error rate  $> TER$ 
    - Do more testing to get SER lower or
    - Conclude control isn't effective

# Sampling Plans

- Determine Test Objective
  - Have sales shipments been billed?
- Define Population and Deviation
  - Take a sample of shipping documents
  - Trace forward to see if they were billed
- Determine Sample Size based on
  - Tolerable Error Rate
  - Risk of assessing Control Risk Too Low
  - Expected Population Error Rate
- Select Sampling Technique
  - Random
  - Sequential
  - Systematic
- Perform Sampling Plan
- Evaluate Results
- Document Results

## Systematic Sampling

- Every certain # of a population is selected
- Population *needs* to be randomly ordered
- Population doesn't require pre-numbering

## Sequential Sampling

- Also called “Stop or Go” Sampling
- Each audit step determines the next step

## Discovery Sampling

- Audit is testing an area that is so crucial that zero population errors can be tolerated
  - Any phony employees on payroll?

## Block Sampling

- Easy to implement, but **worst** method of sampling
  - Example: Auditor picks all transactions from June and then projects the results to the rest of the year

## Data Analytics

- Identifies Trends in Large Amounts of Data
  - Used for Predictions & Decision-Making
  - Used to Identify Fraud
  - Used to Identify patterns (e.g., healthcare transactions for patients)
  - Used in Sampling
- Big Data
  - Volume
    - Quantity of Data

- Veracity
  - Quality or Accuracy of Data
- Velocity
  - Speed at which data is obtained
- Variety
  - Type of data being dealt with
- Types of Analytics
  - Descriptive Analytics
  - Diagnostic Analytics
  - Predictive Analytics
  - Prescriptive Analytics
- Data Visualization
  - Line Chart
  - Bar Chart
  - Pie Chart
  - Histograms
  - Scatterplot
  - Tables

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Discover How Prepared You Really Are.

Choose the section for your quiz

AUD     BEC     FAR     REG

[Start Quiz](#)

# **NINJA CPA Review®**



## **NINJA Notes**

Regulation

# REG

Source: AICPA

Content Area		Allocation
Area I	Ethics, Professional Responsibilities, and Federal Tax Procedures	10–20%
Area II	Business Law	10–20%
Area III	Federal Taxation of Property Transactions	12–22%
Area IV	Federal Taxation of Individuals	15–25%
Area V	Federal Taxation of Entities	28–38%

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# How to use NINJA Notes

## Reading

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If you have 6 weeks to study, then you need to complete this in 4 weeks. 5 weeks to study, then complete it in 3.4 weeks = 2 weeks. You get the picture. The point is: plan, plan, plan and budget, budget, budget, budget because exam day is looming.

### Learning Plans

#### 6-Week Plan

- Approx. 122 pages x 5 reads
- 4 weeks
- 7 days per week = Approx. 22 pages per day

#### 5-Week Plan

- Approx. 122 pages x 5 reads
- 3 weeks
- 7 days per week = Approx. 29 pages per day

#### 4-Week Plan

- Approx. 122 pages x 5 reads
- 2 weeks
- 7 days per week = Approx. 43 pages per day

#### 3-Week Plan

- Approx. 122 pages x 5 reads
- 1 week
- 7 days per week = Approx. 87 pages per day

## Rewriting The NINJA Notes

This step is optional, but it won over a lot of skeptics with its results. This is not mainstream advice. This is the NINJA way. The mainstream way of studying for the CPA Exam is old-fashioned and outdated.

Forget the old way. **You are a NINJA now.**



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2. Rewrite the NINJA Notes.

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# II. Partnership Taxation

## Partnership Basics

- Partnerships are not a legal (taxable) entity
- Income and Expenses flow through to the Partner via a Form K-1

## Property For Partnership Interest Exchange

- Non-Taxable Event: No gain or loss recognized
- Partner's Basis = Basis of Property Contributed
  - Exception: When property has a liability that exceeds basis
- Example: \$4,000 basis with a \$6,000 mortgage for a 20% interest

\$4,000

<\$4,800> (\$6,000 x 80%)

\$800 Capital Gain

- \$0 basis for partner
- \$4,800 basis for Partnership on the property
  - Contributor's Basis + Gain recognized Contributor

## Services For Partnership Interest Exchange

- Taxable Event
- Treated the same as compensation
- Use % of partnership interest

x FMV of partnership

= Taxable Income

- Taxable Income amount becomes basis

## Partnership Holding Period Of An Asset

- Inherits holding period of asset contributed
- Except: Inventory - holding period begins when contributed

## Startup Costs For A Partnership

- Tax treatment same as that of an individual taxpayer
- Syndication fees (preparing offering materials, etc.) are not deductible or amortized

## Deductions To Arrive At Partnership Income

<COGS>

<Wages> (Except for partners)

<Guaranteed Payments>

<Business Bad Debt> (Accrual basis only)

<Interest Paid> (payments to partners are OK)

<Depreciation> (except 179)

<Amortization of Startup Costs>

---

= **Partnership Income**

## Partnership Losses

- Cannot be taken below basis
- Loss is carried forward until basis is available
- Example:

Beginning Basis:	\$2,400
Plus Income:	\$200
Minus Ordinary Loss:	<\$3,000>

---

**\$0**

\$400 Loss gets carried forward until basis is available

## Guaranteed Payments

- Appear in partner's income during year in which fiscal year **closes**
- Example:
  - 6/1/Y1 - 5/31/Y2 Fiscal Year
  - Even if payment was received in Y1, it is income on the Y2 individual return

## Partnership Benefits

- Health Insurance
- Life Insurance
- Treated as guaranteed payments and are self-employment income

## Guaranteed Payments

% Share of Ordinary Partnership Income (Loss) from K1  
+ Guaranteed Payments  
<% share of 179 expense>

---

= Self-Employment Income subject to Self-Employment Tax

## Partner's Basis From Property Contribution

- Contribution of Property: Property's original basis
- Compensation for Services: FMV of % of partnership ownership
- Purchase of a Partnership Interest:
  - Amount of purchase = Basis
- Partnership Interest by Gift:
  - Gift Basis rules apply

## Items Not Deductible On Schedule K

- Instead, these flow to Partners' K-1
  - Investment Interest Expense
  - Foreign Tax Paid
  - Charitable Contributions
  - **179** Expense
- Mnemonic: **IFC179**

# Items Not Counted As Income On Schedule K

- Passive Income
- Portfolio Income
- 1231 G/L
- Mnemonic: **PP1231**

## Partnership Basis Calculation

(This is a simplistic formula for remembering on exam day)

$$\begin{array}{l} \text{Beginning Partnership Basis} \\ + \text{ Capital Contributions} \\ + \text{ Share of Ordinary Income} \\ + \text{ Capital Gains} \\ + \text{ Partner's Share of Partnership Liabilities} \\ + \text{ Tax-Exempt Income (don't forget this!)} \\ \hline = \text{Ending Partnership Basis} \end{array}$$

## Partnership Basis Increase/Decrease

Partnership Basis is **decreased** by:

- Money Distributed
- Adjusted Basis of Property Distributed
- Share of Ordinary Losses
- Partnership is relieved of a liability (distribution)



Partnership Basis is **increased** by:

- Partnership getting a loan

Example:

Beginning Basis	\$15,000
Share of Partnership Income	\$22,000
Tax Exempt Income	\$500
1231 Casualty Gain	\$3,000
1231 non-Casualty Gain	\$2,000
LTCG	\$2,500
	<hr/>
	\$30,000
Total	\$45,000
Less:	
STCL	<\$2,000>
Charitable Contributions	<\$3,000>
	<hr/>
Ending Basis	\$40,000

Note: Guaranteed Payments do not affect basis

## Order Of Adjustment To Basis

- Increase basis in share of liabilities
- Increase basis from all income items - including tax-exempt income

- Decrease basis for distribution
- Decrease basis for losses (limited to basis)
- Gains are always allowed in related-party transactions
  - 33% partner sells property to a partnership at a \$6,000 gain
  - Partner recognizes a \$6,000 capital gain on K-1
- A 50% or more partner who contributes capital gain property to partnership, who in return won't use it as capital gain property, treats the gain as ordinary and so will the partnership

## **Partnership Taxable Year**

- Due Date: 3/15 plus a six-month extension
- Must be the same as 50% of partners and use the same tax year for 3 years

## **Death Of A Partner**

- Taxable year only closes with respect to partner and their partnership interest

## **Partnership Terminates**

- When less than two partners
- Operation Ceases

## Sale Of Partnership Interest

- Results in a Capital Gain/(Loss)
- Amount Realized – Basis in Partnership = Gain/(Loss)
- Basis = Capital Account + Liabilities Assumed
- Any assets sold not capital in nature = Ordinary Gain
  - Unrealized Receivables
  - Appreciated inventory

## Section 754 Election / Section 743(B) Adjust

- Adjustment amount equals the difference between the value of the outside basis to the transferee partner and the inside basis of the same partner. The objective is to ensure that the inside basis of the asset is equal to the outside basis.
  - Optional for Gains
  - Mandatory for Losses
    - Inside Basis > Outside basis by \$250,000+

## Partner's Share Of Ordinary Gain

$$\begin{array}{l} \text{FMV of Assets (non-capital)} \\ \text{<Adjusted Basis of non-capital assets>} \\ \hline = \text{ Ordinary Gain} \\ \times \text{ Partnership Interest \%} \\ \hline = \text{ Partner's share of ordinary gain} \end{array}$$

**Note:** Partnerships recognize NO G/L on a Distribution

## Distribution: Order Of Basis Reduction

1. Money received
2. Adjusted basis of unrealized receivables and inventory
3. Adjusted basis of other property

**Note:** Only MONEY distributions will trigger a gain in a partnership distribution

## Liquidating & Non-liquidating Distributions

- A loss can **ONLY** occur in a liquidating distribution
- Requirements for a loss to be recognized:
  1. Money was received
  2. Unrealized receivables received
  3. Appreciated inventories received
- Otherwise, no loss recognized
- Example: Liquidating Distribution

Partner's Basis in partnership:	\$60,000
Partner Receives property	
Partnership Basis in that property:	\$20,000
Partner's Cash received:	\$10,000

**Note:** You ignore the property distribution of \$20,000 for this calculation

Basis  
 <Cash>  
 <Receivables Received>  
 <Inventory Received>  
 <Property Distributed>

---

Any Remainder = Capital Loss

\$60,000    Basis  
 <\$10,000>    Cash Received

---

\$50,000    Basis  
 <\$50,000>    (whatever amount takes basis to zero)

---

\$0

- Example: Non-Liquidating Distribution

Partner's Basis in Partnership:	\$9,000
Money Received:	<\$5,000>
	<hr/>

Remaining Partner's Basis:            \$4,000

Partnership's Basis in Property:        \$3,000

Use lesser of partner's remaining basis or partnership's basis in property to calculate partner's basis in property

Basis Remaining:	\$4,000
Partner's Basis in Property:	<\$3,000>
	<hr/>

Remaining Partnership Interest:        \$1,000

# REG NINJA Notes (Full Version)

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AUD  BEC  FAR  REG

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# **NINJA CPA Review®**



## **NINJA Notes**

Business Environment & Concepts



# BEC

Source: AICPA

Content Area		Allocation
Area I	Enterprise Risk Management, Internal Controls, and Business Processes	20-30%
Area II	Economics	15-25%
Area III	Financial Management	10-20%
Area IV	Information Technology	15-25%
Area V	Operations Management	15-25%

## Skill Levels

Evaluation	The examination or assessment of problems, and use of judgment to draw conclusions.
Analysis	The examination and study of the interrelationships of separate areas in order to identify causes and find evidence to support inferences.
Application	The use or demonstration of knowledge, concepts or techniques.
Remembering and Understanding	The perception and comprehension of the significance of an area utilizing knowledge gained.

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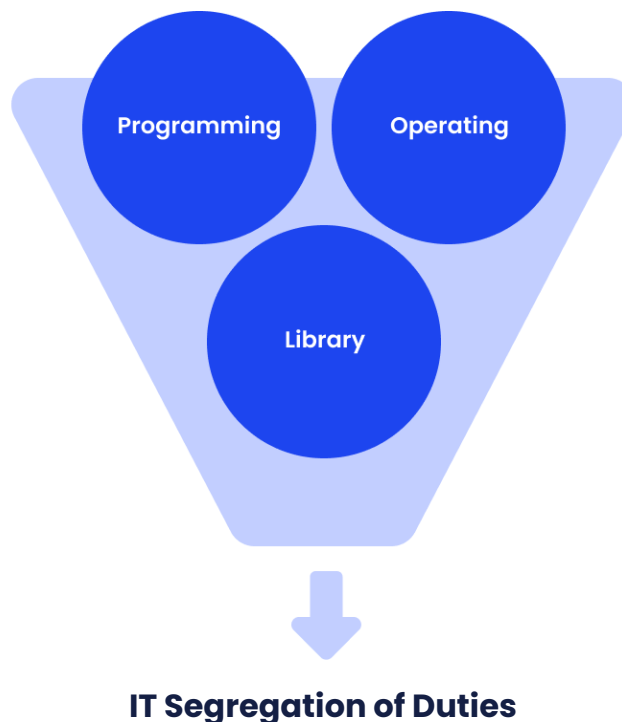


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## II. Information Technology



- Segregated IT Roles
  - Operators (administrators), Programmers (engineers), & Librarians (custodians)
- Systems Analyst
  - Designs or purchases IT System
  - Responsible for Flowcharts
  - Liaison between Users and Programmers
- Systems Administrator
  - Controls Database Access
- Systems Programmer

- Writes, Updates, Maintains, & Tests software, systems, and compilers
- Control - Systems Programmer can't also have application programming duties
- Control - Programmer can't be an Operator
- Systems Operator
  - Schedules and Monitors Jobs
  - Runs IT Help Desk
  - Control - Operator can't be a Programmer
- Compensating Controls
  - Use if duties can't be segregated
  - Include Computer Logs or two-factor authentication for audit trail
  - *Control Group* reviews logs

## **Management Information Systems (MIS)**

- Used for decision-making
- Accounting Information System (AIS)
  - Type of MIS
  - Processes Transactions
- Executive Information System (EIS)
  - Specialized for Company Executive needs
  - Assists with Strategy Only

- No Decision-Making Capabilities
- Expert System (ES)
  - Computer uses reasoning
  - Structured
  - No human interpretation needed
- Decision Support System (DSS)
  - Computer provides data
  - Gives Interactive Support
  - Human interpretation needed

<b>AIS</b> ▼	<ul style="list-style-type: none"> <li>● Processes Transactions</li> </ul>
<b>EIS</b> ▼	<ul style="list-style-type: none"> <li>● Specialized</li> <li>● Strategy Only - No Decision Making</li> </ul>
<b>ES</b> ▼	<ul style="list-style-type: none"> <li>● Structured</li> <li>● Computer Uses Reasoning</li> <li>● No Human Interpretation</li> </ul>
<b>DSS</b> ▼	<ul style="list-style-type: none"> <li>● Computer Provides Data</li> <li>● Interactive Support</li> <li>● Requires Human Interpretation</li> </ul>

## Computing And Reports

- Ad Hoc
  - User Initiates on Demand

- Example: Query

- Exception
  - Produced when Edit Tests, Check Digits, or Self-Checking Digits identify a problem
- End-User Computing
  - User develops and executes own application

## **E-Commerce**

- Benefits
  - Makes business transactions easier
- Risks
  - Compromised data or theft
  - Less paper trail for auditors
- Electronic Data Interchange (EDI)
  - Uses globally-accepted standards
  - Efficient

## **Networks**

- File Server
  - Stores shared programs and documents
- Database
  - Located on File Server



- Allows users to share documents
- LAN (Local Area Network)
  - Connects computers in close proximity
- WAN (Wide Area Network)
  - Connects computers that are far apart
- VAN (Value-Added Network)
  - Privately-owned Network
  - Serves as 3<sup>rd</sup> Party Between 2 Companies
  - Routes EDI Transactions
  - Accepts a wide range of Protocols
  - Very Costly

## **Network Risk**

- Firewall
  - Prevents unauthorized access to network
- Virus
  - Takes over a computer
  - Needs a host program to run
- Worm
  - Takes over multiple computers
  - Doesn't need a host program to run

Worm – No host needed

Virus – Host needed



## Computer Hardware

- Automated Equipment Controls
  - Prevents and detects Hardware Errors
- RAM
  - Internal Memory
- CPU
  - Process Commands within computer
- Job Control Language
  - Schedules and allocates system resources
- Input Device Examples
  - Keyboard & Mouse
  - Scanner
  - Magnetic Ink Reader
  - Magnetic Tape Reader
  - EDI
  - Point of Sale Scanner

- Output Device Examples
  - Speakers & Monitor
- Gateway
  - Connects one network to another
  - Internet is connected by Gateways

## **Computer Hardware & Software Controls**

- Parity Checks
  - Detects internal data errors
  - Bit added to each character; Checks to see if a bit was lost
- Echo Check
  - Transmitted data is returned to sender for verification (Think: Echoes back to you)
- Change Control
  - Authorizes program changes and approves program test results
- Security Software
  - Controls access to IT systems
  - Don't confuse this with anti-virus software
- Digital Signature
  - Confirms message has not been altered

# Computer Types

- PDA / Smartphone / Tablet
- Microcomputer
  - PC / Laptop – Cost-effective
- Minicomputer
  - Like a Mainframe, but smaller
- Mainframe
  - Large computer with terminals attached
- Supercomputer
  - Very powerful and very big



# Computer Terms

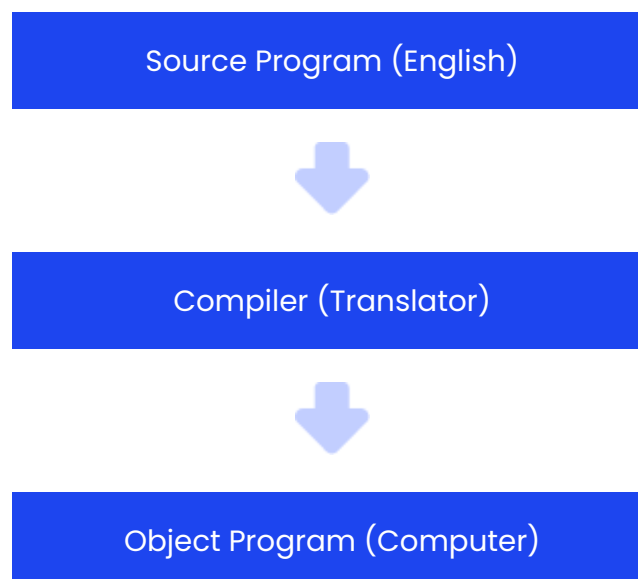
- Bit
  - 1=ON
  - 0=OFF
- Byte
  - 8 Bits = 1 Character
- Field

- Group of Related Characters
- Ex: Zip Code
- Record
  - Group of Related Fields
  - Ex: Member Name/Address/City/State/Zip
- File
  - Group of Related Records
  - Ex: Membership Directory



# Computer Languages

- Design Engineers
  - Determine language used for a specific computer; C, C++, Java, Python, Ruby
- Source Programs
  - Written in English
- Object Programs
  - Language computers understand
- Compiler
  - Translator: Takes Source language (English) and converts to Object (Computer) Language



# Computer Processing

- Online Analytical Processing
  - Uses a Data Warehouse to support management decision-making
  - Data Mining with a large volume of information
- Uses Artificial Intelligence and Pattern Recognition to analyze data stored in a Data Warehouse
- Online Transaction Processing
  - Processes a company's routine transactions
  - Real-time transactions with reporting capabilities
- Batch Processing
  - Update files all at once (e.g., 12 am payroll)
  - How scores are currently processed
  - Leaves a better audit trail
  - Uses Grandfather-Father-Son Back-up
    - 3 Levels of Back-up
    - Kept in 3 different locations

<b>Online</b>	<ul style="list-style-type: none"><li>● Instant (Real Time)</li><li>● Processes Transactions as They Occur</li></ul>
<b>Batch</b>	<ul style="list-style-type: none"><li>● Held</li><li>● Processed all at Once</li><li>● Easier to Audit</li></ul>

# Computer Output Controls

- Output Control
  - Was output data valid, distributed, and used in an authorized manner?
- Processing Control
  - Did data processing produce proper output?

# Computer Input Controls

- Hash Total (Input Control)
  - Sum of Meaningless Numbers
  - Sum of Social Security Numbers
  - Tip: When encountering a question about a Hash Total on the exam, think, "Which answer, when added, would add up to non-sense?" i.e. adding up 10 peoples' social security numbers?
- Validity Check (Input Control)
  - Compares data to existing tables or files
  - Does a certain answer belong?
    - Ex: # in a Y/N blank
    - Ex: Is this person a customer?
- Limit Check (Input Control)
  - Can't surpass a certain limit
    - Ex: Age >110 in fill-in-blank
- Check Digit (Input Control)



- Adds an identification number to a set of digits – usually at the end
- Field Check (Input Control)
  - Prevents invalid characters
    - Prevents alphabetic letters from being entered into an SSN# field

## Disaster Recovery

- Hot Site – Alternate location takes over immediately
- Cold Site – Alternate location needs time to set up

## Flowchart Symbols

- Alternate Process



- Connector



- Decision (Think D for Diamond)



- Document



- Manual Operation



- Process



- Terminator



## Computer Databases

- SQL (Sequel) - Structured Query Language
  - Most common database language

## **Data Definition Language**

- Defines Database
- Controls Tables

## **Data Manipulation Language**

- Queries Tables

## **Data Control Language**

- Controls Access

- Relational Database
  - Logical structure
  - Uses rows and columns similar to spreadsheet
  - CRUD: Create, Read, Update, Delete
- Hierarchical Database
  - Has various levels
  - Uses Trees to store data
- Database Advantages
  - Data more accessible
  - Reduced Redundancy
  - Easy to add and delete records
- Database Disadvantages

- Cost of installation
- Skilled personnel required to maintain (database admin)
- 3-Layer System
  - Desktop Client
  - Application Server
  - Database Server
  - Think: Your desktop computer runs applications and saves to a database

## **COBIT**

- Globally-accepted set of IT best-practices for the Board, Executives, and Management
- Aligns the goals and objectives of the organization with IT
- Improves IT efficiency and cost-effectiveness
- Helps management to manage their IT investment
- Provides for a common language between IT and management
- Aids an organization with SOX compliance

## **It Terminology To Memorize**

- Artificial Intelligence / Machine Learning
  - Technology that mimics human behavior
- Automation

- Third Parties (Payroll, Banks) send client's data directly to the CPA
- Big Data / Data Analytics
  - Identifies Trends in Large Amounts of Data
    - Used for Predictions & Decision-Making
    - Used to Identify Fraud
    - Used to Identify patterns (e.g., healthcare transactions for patients)
- Data Visualizations
  - Puts Accounting data into a visual form
  - Charts, Graphs, Images
  - Makes Data Meaningful for Decision-Making
- Blockchain
  - Technology behind Bitcoin
  - Uses Distributed Ledgers
  - Think decentralization (vs centralization)
  - Captures accounting data in real-time
  - Advantage: Makes fraud harder
  - Disadvantage: Susceptible to price volatility and mostly available on the Internet
- Cryptocurrencies (Bitcoin)
  - Digital Asset / Currency (Think online gold)
  - Decentralized
  - Uses Cryptography

- Difficult to Counterfeit but easy to replicate (Ethereum)
- Bitcoin first Decentralized Cryptocurrency
  - Uses Blockchain
  - Each transaction is stand-alone
- Cloud Operations / Data Storage
  - Storage of Files/Data on Third-Party Servers over the Internet (vs Internal)
    - More Convenient
    - Cost-Effective
    - Risk of Hacking / Unauthorized Access
    - 3<sup>rd</sup> parties manage data and risk
    - Public and private clouds available
- Cyber-security
  - Security protocols to prevent Unauthorized Access to Computers, Files, or Documents
  - Firewalls, software and hardware related, could prevent hackers from breaking into an internal information system
- Digital Business Models
  - Leverage online and physical assets for competitive advantages in the marketplace

## **Data Analytics**

- Big Data
  - Volume
    - Quantity of Data

- Veracity
  - Quality or Accuracy of Data
- Velocity
  - Speed at which data is obtained
- Variety
  - Type of data being dealt with
- Types of Analytics
  - Descriptive Analytics
  - Diagnostic Analytics
  - Predictive Analytics
  - Prescriptive Analytics
- Data Visualization
  - Line Chart
  - Bar Chart
  - Pie Chart
  - Histograms
  - Scatterplot
  - Tables

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