

Audit and Assurance Practice Exam Sample Study Guide



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Questions

- 1. If an auditor finds evidence that a significant audit procedure was omitted, what is the recommended course of action?**
 - A. Ignore it unless issues arise later.**
 - B. Immediately re-audit the entire financial statement.**
 - C. Communicate the findings to the appropriate parties.**
 - D. Change the audit report to reflect the omission.**
- 2. True or False: If the risk of material misstatement is assessed as low, the auditor can be less flexible about the timing of procedures.**
 - A. True**
 - B. False**
 - C. Only for substantive testing**
 - D. Depends on control effectiveness**
- 3. Does ISA 701 mandate the order of presentation of KAMs?**
 - A. Yes, it mandates the order of KAM presentation.**
 - B. No, the auditor can choose the order.**
 - C. Only for certain types of audits.**
 - D. Yes, but only for financial audits.**
- 4. What type of agreement is typical in a just-in-time manufacturing process?**
 - A. An agreement for bulk purchasing**
 - B. An agreement to ship merchandise according to production schedules**
 - C. An agreement to defer payments until delivery**
 - D. An agreement for fixed inventory levels**
- 5. How does a new product introduction typically affect days' sales in inventory in terms of expectations?**
 - A. Days' sales in inventory is expected to stay the same**
 - B. Days' sales in inventory is likely to increase**
 - C. Days' sales in inventory is expected to decrease**
 - D. Days' sales in inventory may fluctuate without warning**

- 6. What should auditors consider when evaluating a change in accounting principles?**
- A. Only compliance with legal standards**
 - B. The potential impact on financial statement users**
 - C. Recent trends in the industry**
 - D. Management's justification alone**
- 7. Which of the following is NOT a task performed by an automated purchasing system?**
- A. Automatically flagging invoices that reconcile with purchase orders.**
 - B. Creating change orders.**
 - C. Applying preloaded specifications to initiate processes.**
 - D. Analyzing variances from purchase orders.**
- 8. What is one of the main reasons for an auditor to be skeptical of a client's financial practices?**
- A. The client holds too many financial assets**
 - B. There's an absence of cash transaction documentation**
 - C. The client has an excellent financial record**
 - D. The client engages in frequent investments**
- 9. If a company introduced a new product with a low price point, what change is expected in the inventory turnover?**
- A. It is expected to remain unchanged**
 - B. It is expected to increase**
 - C. It is expected to decrease**
 - D. It is expected to fluctuate frequently**
- 10. In the audit procedure related to marketable securities, which assertion requires the auditor to examine documents for restrictions?**
- A. Completeness**
 - B. Valuation**
 - C. Rights and obligations**
 - D. Existence**

Answers

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1. C
2. B
3. B
4. B
5. C
6. B
7. A
8. B
9. B
10. C

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Explanations

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1. If an auditor finds evidence that a significant audit procedure was omitted, what is the recommended course of action?

- A. Ignore it unless issues arise later.**
- B. Immediately re-audit the entire financial statement.**
- C. Communicate the findings to the appropriate parties.**
- D. Change the audit report to reflect the omission.**

When an auditor discovers that a significant audit procedure has been omitted, the appropriate course of action is to communicate the findings to the appropriate parties. This step is crucial because it ensures transparency regarding the audit process and helps maintain the integrity of the audit. By informing relevant stakeholders—such as management and those charged with governance—the auditor provides an opportunity to assess the potential impact of the omitted procedure on the overall audit opinion. Communicating the findings allows for further evaluation of whether the omission materially affects the financial statements. It also helps in determining whether additional procedures should be performed to mitigate any potential risks or issues arising from missed audit steps. This communication is essential for maintaining professional standards and fostering trust between the auditor and the entities involved. The emphasis here is on accountability and ensuring that all parties are aware of the situation so that they can take appropriate actions, which may include performing additional audit procedures to address any shortcomings.

2. True or False: If the risk of material misstatement is assessed as low, the auditor can be less flexible about the timing of procedures.

- A. True**
- B. False**
- C. Only for substantive testing**
- D. Depends on control effectiveness**

The correct response is based on the understanding of how auditors manage the timing of their procedures in relation to the assessed risk of material misstatement. When the risk is assessed as low, it typically indicates that the auditor may rely more on the effectiveness of internal controls. However, this does not grant them less flexibility regarding the timing of their audit procedures. In fact, auditors can adjust the timing of their procedures based on various factors, including materiality thresholds, the nature of the entity's operations, and compliance with regulatory deadlines. Even with a low risk assessment, the timing of procedures can still be influenced by other considerations, allowing for flexibility in the planning and execution of the audit. Furthermore, the nature of substantive testing does not inherently restrict the auditor's flexibility related to timing, nor does it allow for different rules based on the risk of material misstatement. Understanding that control effectiveness plays a major role in the assessment, it is critical to recognize that the timing of audit procedures can remain flexible regardless of the perceived risk, as long as it meets overarching audit objectives and complies with applicable standards.

3. Does ISA 701 mandate the order of presentation of KAMs?

A. Yes, it mandates the order of KAM presentation.

B. No, the auditor can choose the order.

C. Only for certain types of audits.

D. Yes, but only for financial audits.

International Standard on Auditing (ISA) 701 addresses the communication of Key Audit Matters (KAMs) in the auditor's report for audits of financial statements. One of the key features of ISA 701 is that it provides auditors with the flexibility to select and present KAMs based on their significance and relevance to the audit conducted. This means that while the standard requires the auditor to identify and communicate KAMs, it does not mandate a specific order for their presentation. Auditors can organize KAMs in a way that they believe best reflects the circumstances of the audit and the nature of the matters themselves. This flexibility allows for a more tailored and contextual presentation that can enhance the understanding of users of the financial statements. The other options imply a restriction or requirement concerning the order of KAM presentation, which is not supported by the standards set forth in ISA 701. Therefore, the answer indicating that the auditor can choose the order aligns with the principles of ISA 701 and the intention behind it to promote clarity and relevance in reporting KAMs.

4. What type of agreement is typical in a just-in-time manufacturing process?

A. An agreement for bulk purchasing

B. An agreement to ship merchandise according to production schedules

C. An agreement to defer payments until delivery

D. An agreement for fixed inventory levels

In a just-in-time (JIT) manufacturing process, the goal is to minimize inventory levels and reduce waste by receiving goods only as they are needed in the production process. This approach requires a high level of coordination between the manufacturer and its suppliers to ensure that materials are delivered at exactly the right time to meet production schedules. The correct answer reflects the essence of JIT, wherein the agreement to ship merchandise according to production schedules allows manufacturers to operate efficiently without holding excessive inventory. This arrangement supports the JIT philosophy by enabling continuous production flow and responding quickly to demand changes, thus ensuring that materials arrive precisely when required for production. Other types of agreements, such as those for bulk purchasing, deferral of payments, or maintaining fixed inventory levels, do not align with the principles of JIT. Bulk purchasing typically involves storing large quantities of inventory, which contradicts the JIT approach of minimizing stock. Similarly, deferring payments until delivery doesn't inherently address the timing of material availability in relation to production needs, while fixed inventory levels do not facilitate the adaptive and responsive nature that JIT requires.

5. How does a new product introduction typically affect days' sales in inventory in terms of expectations?

- A. Days' sales in inventory is expected to stay the same**
- B. Days' sales in inventory is likely to increase**
- C. Days' sales in inventory is expected to decrease**
- D. Days' sales in inventory may fluctuate without warning**

When a new product is introduced, it often leads to an increase in sales excitement and consumer interest, which can contribute to a quicker turnover of inventory. This frequently results in a decrease in the days' sales in inventory metric, as the business aims to adjust its inventory levels more efficiently in response to market demand and consumer preferences. A product launch typically means that a company will not only aim to optimize its inventory practices to accommodate the new product but will also likely experience an initial boost in sales. As the product gains traction in the market, inventory is sold faster, leading to a reduction in the amount of time that inventory sits before it is sold. Therefore, the expectation is that days' sales in inventory will decrease as inventory is sold more rapidly to meet new demand. Days' sales in inventory measurements focus on how long it typically takes to sell the entire inventory, and with an effective marketing strategy and consumer interest in a new product, businesses often find that they achieve shorter inventory cycles, reflecting a decrease in this metric. Hence, the expectation is a decrease in the days' sales in inventory with the introduction of a new product.

6. What should auditors consider when evaluating a change in accounting principles?

- A. Only compliance with legal standards**
- B. The potential impact on financial statement users**
- C. Recent trends in the industry**
- D. Management's justification alone**

When evaluating a change in accounting principles, auditors need to consider the potential impact on financial statement users. This is crucial because the primary purpose of financial statements is to provide useful information to stakeholders, including investors, creditors, and regulators. Any change in accounting principles can affect the comparability, reliability, and relevance of the financial information presented, which in turn influences users' decisions. Understanding how a change will affect users' interpretation of the financial statements ensures that the auditors assess whether the change enhances or diminishes the quality of the information being reported. This involves analyzing the implications of the new accounting policy on key financial metrics, such as revenue recognition and asset valuation, and ensuring that stakeholders are adequately informed about these changes. While compliance with legal standards, recent trends in the industry, and management's justification may all play roles in the evaluation process, they do not capture the core concern of how the change will ultimately affect those who rely on the financial statements for their economic decisions. The emphasis on users' impact aligns with the auditors' responsibility to provide assurance that the financial statements are not only compliant but also useful and informative.

7. Which of the following is NOT a task performed by an automated purchasing system?

A. Automatically flagging invoices that reconcile with purchase orders.

B. Creating change orders.

C. Applying preloaded specifications to initiate processes.

D. Analyzing variances from purchase orders.

An automated purchasing system is designed to streamline various tasks involved in procurement processes. Among the functions it typically performs are creating purchase orders, managing supplier information, and facilitating communication between the purchasing department and vendors. The task of automatically flagging invoices that reconcile with purchase orders is generally related to the accounts payable process, which reviews and approves invoices after the purchasing process has already occurred. It ensures that the goods or services received match what was ordered but isn't a primary function directly executed within the purchasing system itself. On the other hand, creating change orders, applying preloaded specifications to initiate processes, and analyzing variances from purchase orders are all tasks that emphasize the system's involvement in the procurement workflow. Creating change orders allows for adjustments to purchase orders when necessary, applying specifications ensures consistency and accuracy in the purchasing process, and analyzing variances helps in monitoring price discrepancies or delivery issues, which are key components of managing supplier relationships and procurement efficiency. In summary, automatic invoice reconciliation is more of an accounts payable function rather than a core task of an automated purchasing system, making it the option that does not align with the standard operations typically associated with such systems.

8. What is one of the main reasons for an auditor to be skeptical of a client's financial practices?

A. The client holds too many financial assets

B. There's an absence of cash transaction documentation

C. The client has an excellent financial record

D. The client engages in frequent investments

Being skeptical of a client's financial practices is crucial for an auditor as it helps ensure the accuracy and integrity of the financial information being presented. In this case, the absence of cash transaction documentation is a significant red flag. Documentation serves as evidence that transactions have been executed and recorded accurately, and its absence can indicate potential issues such as fraud, mismanagement, or errors in reporting. Without proper documentation for cash transactions, there is an increased risk that the financial statements may not reflect the true financial position of the client. Auditors rely heavily on such documentation to verify transactions and to support the assertions made in the financial statements. Thus, the lack of this documentation raises doubts about the reliability of the financial practices and encourages auditors to exercise increased skepticism and perform additional procedures to gather sufficient evidence. The other options do not inherently suggest a need for skepticism. Holding too many financial assets may indicate strong financial management or strategic growth. Having an excellent financial record typically instills confidence rather than skepticism. Frequent investments may be a standard business practice and could reflect a healthy growth strategy rather than a cause for concern.

9. If a company introduced a new product with a low price point, what change is expected in the inventory turnover?

A. It is expected to remain unchanged

B. It is expected to increase

C. It is expected to decrease

D. It is expected to fluctuate frequently

When a company introduces a new product at a low price point, it typically aims to attract a larger customer base and stimulate higher sales volumes. This increase in sales can lead to a more rapid turnover of inventory due to the higher demand for the product. Inventory turnover is calculated by dividing the cost of goods sold (COGS) by the average inventory during a specific period. With a low price point product generating more sales, COGS is likely to increase significantly if the demand is robust, while the inventory may be sold off more rapidly. Consequently, the ratio of COGS to average inventory will increase, resulting in a higher inventory turnover. Additionally, a successful low-price strategy often attracts increased consumer interest, leading to quicker sales cycles and reducing the time that inventory sits unsold. The overall expectation is that as sales accelerate against a potentially stable or even slightly decreasing average inventory level, the inventory turnover ratio will rise accordingly.

10. In the audit procedure related to marketable securities, which assertion requires the auditor to examine documents for restrictions?

A. Completeness

B. Valuation

C. Rights and obligations

D. Existence

The assertion related to examining documents for restrictions in the audit procedure for marketable securities is focused on rights and obligations. This assertion requires auditors to confirm that the entity has the legal rights to the securities it holds and that these securities are free from any obligations or claims by third parties. When auditors examine documents, they look for any restrictions that may limit the use, transfer, or disposal of the securities. Such restrictions could stem from legal agreements, contracts, or regulatory requirements. Understanding these rights is essential in ensuring that the company can exercise its ownership of the securities without encumbrances and that any restrictions are clearly acknowledged and accounted for in the financial statements. This is a critical aspect of the audit process because it ensures that investors and stakeholders receive an accurate picture of the entity's holdings and any potential liabilities associated with those holdings. Validating the rights and obligations supports the overall accuracy and reliability of financial reporting related to marketable securities.