

INTER COURSE: GROUP II
PAPER-5: AUDITING AND ETHICS

(MTP 7: Ch. 5 – Audit of Items of Financial Statements)

Time Allowed- 20 Minutes

Maximum Marks-10

Write the most appropriate answer to each of the following multiple-choice questions by choosing one of the four options given. All MCQs are compulsory and carry 2 Marks each.

- 1 During the audit of Saffron Piping Ltd., the auditor reviewed additional regulatory information prepared under Schedule III. Management informed that a property was attached during the year under the applicable law relating to benami transactions and that a show-cause notice had been issued to the company. The auditor noted that the property was never recorded in the books earlier and that proceedings were still pending. The finance team requested clarity on the exact disclosures required in the notes forming part of the financial statements. He should have documented the explanation received, the evidence reviewed and how he concluded that the corrections were appropriate.
- What disclosures are required when a company holds benami property as per the reporting requirements of Schedule III?
- (a) The company must disclose only the fact of proceedings and attach the authority's notice, without providing any additional particulars, since the matter is under adjudication and premature to expand upon.
 - (b) The company must disclose details of such property, including whether it is in the books, the nature of proceedings, the identity of the transactions, and the reasons why the property is considered benami, along with the status of the proceedings.
 - (c) The company is required to disclose only the fair value of the property and a general note that proceedings are ongoing, as Schedule III primarily focuses on measurement aspects rather than descriptive particulars.
 - (d) The company need not disclose any information if legal representation has been submitted, since disclosure is required only after final attachment or confiscation orders are passed under the applicable law.
- 2 During the audit of Nivora Engineering Ltd., the auditor reviewed several expense categories including repairs, sales promotion, and travel reimbursements. While checking randomly selected vouchers, the auditor noticed variations in supporting documents such as missing approvals, altered dates, and inconsistent narration of purpose. Some vouchers carried amounts just below internal authorization limits, raising concerns of possible splitting. The audit team decided to reassess the parameters to be applied while vouching expenditure entries.

Which set of attributes should the auditor primarily examine while vouching expenses to ensure their genuineness and propriety?

- (a) The auditor should mainly check whether expenses relate to a recurring or non-recurring nature and whether they match last year's trend, without going deeply into authorization or supporting documentation.
- (b) The auditor should verify that each expense is properly authorized, supported by documentary evidence, relates to the business, and is recorded in the correct accounting period, while also evaluating its reasonableness.
- (c) The auditor should focus largely on mathematical accuracy of postings, cross-casting of expense ledgers, and whether book totals reconcile with the trial balance, since vouching does not concern itself with purpose or approval.
- (d) The auditor should consider whether expenses were disbursed through cash or bank and merely ensure that corresponding entries appear in the cash book or bank book, as linkage to underlying documents is generally not required.

Case Scenario [MCQ 3-5]

Ardent Tools & Components Ltd. (ATCL), a medium-sized manufacturing company, expanded its operations during the current year by raising additional capital and utilizing certain reserves. At the beginning of the year, its equity share capital stood at ₹8 crore consisting of 80 lakh equity shares of ₹10 each, all fully paid. Mid-year, to fund a new machining line, ATCL issued 10 lakh new shares at a premium of ₹20 per share. The allotment was approved through a board resolution, and the related Form PAS-3 was filed within the prescribed time. The auditor noted that the amount collected towards the premium was fully credited to the securities premium account, but management had also proposed to utilize a part of the premium for writing off certain advertisement campaign expenses incurred at the time of the share issue.

ATCL also had an opening general reserve of ₹2.40 crore. During the year, the company transferred ₹60 lakh from surplus (profit & loss) to general reserve as per the board's recommendation. A final dividend of ₹1 per share was proposed for the current year, though the approval from shareholders would occur after the balance-sheet date. The auditor reviewed this, considering whether it required recognition or only disclosure. The financial statements also showed a capital reserve balance created years ago from profit on sale of an old factory building; no movement took place in the current year.

While examining the utilisation of reserves, the auditor observed that the company had applied ₹50 lakh from the general reserve towards expansion of warehouse facilities. The management contended that such utilisation aligned with internal policy for long-term capacity enhancement. For share capital verification, the auditor compared the closing balance with last year's audited financials, reviewed the authorised capital limits, and checked that the new paid-up capital remained within those limits. The auditor also verified the reconciliation of the number of shares outstanding as required under the financial reporting framework.

A reconciliation prepared by ATCL showed that share capital increased to ₹9 crore at year end, and reserves & surplus aggregated to ₹4.50 crore after considering current-year transfers and utilisation. Before concluding, the auditor considered whether classification and disclosure requirements—such as rights, restrictions, movement in reserves, and any amounts earmarked—were properly presented in the notes.

Based on the above facts, answer the following:

- 3 The auditor observes that ATCL utilised ₹50 lakh from general reserve for warehouse expansion. Which is the most appropriate audit conclusion regarding such utilisation?
- (a) The utilisation is impermissible as general reserve can only be used for dividend distribution or bonus issue, requiring correction.
 - (b) The utilisation may be acceptable if it aligns with board-approved policy and does not violate statutory restrictions on revenue reserves.
 - (c) Utilisation is automatically treated as capital reserve, requiring reclassification in the balance sheet.
 - (d) Such utilisation must always be reversed unless authorised by the shareholders through a special resolution.
- 4 ATCL issued 10 lakh shares at a premium of ₹20. Management proposes to use a portion of the premium to write off advertisement expenses of the issue. Which audit view is most appropriate?
- (a) Issue expenses may be written off from general reserve only, and securities premium cannot be used under any circumstances.
 - (b) The securities premium account may be utilised freely for any business operational expenditure at management's discretion.
 - (c) Premium can be utilised only for permitted purposes such as issue expenses, and the auditor must verify compliance with statutory limits before accepting the adjustment.
 - (d) Premium cannot be used for any purpose in the same year of receipt, but only after one full financial year as per conservative accounting norms.
- 5 ATCL's proposed dividend of ₹1 per share is approved by the board before year end but approved by shareholders after the balance-sheet date. How should the auditor evaluate its treatment?
- (a) It must be recognised as a liability since the board has already recommended it before the balance-sheet date.
 - (b) It should not be recognised as a liability at year end but must be disclosed as an event after the reporting period.
 - (c) It requires adjustment against surplus and must reduce the general reserve balance.
 - (d) Dividend should be charged to securities premium account when approved after the reporting date as per prudence.

CA Inter – Auditing and Ethics

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Detailed Schedule of MCQ Test Series – Nov. 2025

Date	Day	Topic	MCQ Style	Marks
6 Nov.	Wed.	Ch. 1 - Nature, Objective and Scope of Audit	1 Case Study with 4 MCQ + 1 General MCQ	10
7 Nov.	Thu.	Ch. 11 - Ethics and Terms of Audit Engagements		10
8 Nov.	Fri.	Ch. 2 - Audit Strategy, Planning & Programme		10
10 Nov.	Mon.	Ch. 3 - Risk Assessment and Internal Control		10
12 Nov.	Wed	Ch. 4 - Audit Evidence		10
14 Nov.	Fri.	Ch. 6 - Audit Documentation		10
17 Nov.	Mon.	Ch. 5 - Audit of Items of Financial Statements		10
19 Nov.	Wed	Ch. 7 - Completion and Review		10
24 Nov.	Mon.	Ch. 8 - Reporting		10
26 Nov.	Wed	Ch. 9 - Audit of Different Types of Entities		10
28 Nov.	Fri.	Ch. 10 - Audit of Banks		10

**Note: Test Papers and Answer Key will be uploaded
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2	Ch. 2 - Audit strategy, Planning and Programme	29 Nov. 2025
	Ch. 3 - Risk Assessment and Internal Control	
3	Ch. 4 - Audit evidence	03 Dec. 2025
	Ch. 6 - Audit Documentation	
4	Ch. 5 - Audit of Items of Financial Statements	06 Dec. 2025
5	Ch. 7 - Completion and Review	10 Dec. 2025
	Ch. 8 - Audit Report	
6	Ch. 9 - Sp. features of Audit of Different Entities	13 Dec. 2025
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