

## Test checking/selective verification

### Concept

**5.4-1** Test checking has been defined by *Megis* as,

"A means to select and examine a representative sample from a large number of similar items."

Thus, test checking implies selecting a few transactions on the basis of auditor's judgment and examining them. The opinion formed by the auditor after such checking is extended to the whole set of transactions, which is referred to as population/universe and portion of universe selected and examined is called sample. The universe is composed of all items of similar nature.

### Importance

**5.4-2** Test checking is extensively applied by auditor. For example, arithmetical accuracy checks are undertaken and debtor's confirmations are obtained usually on test check basis. But the use and extent of test checking is dependent upon the system of internal check in operation for the business. More efficient the internal check system, lesser the extent of test checking.

### Safeguards for the application of test checking

**5.4-3** Test checking should be carried out intelligently and carefully, otherwise it may lead to dangerous consequences. Certain safeguards should be taken to ensure reliability of results of test checking. These are mentioned below :

- (i) **Representativeness of the sample** - The sample selected should be representative in character i.e., work of almost all clerks of the client and transactions from all of the books should be included in it. Moreover, universe from where sample is being selected should be homogeneous in nature.

- (ii) **Random selection** - The selection of sample must be done on a random basis. The auditor may use random tables and various computer programmes for this purpose.
- (iii) **Complete examination** - Some transactions like opening and closing entries, depreciation entries and non-recurring or exceptional transactions e.g. related party transactions or overseas sales should not be subject to test check. Cash book and pass book should also be thoroughly checked.
- (iv) **Ensure complete coverage of transactions** - Test checking is normally conducted in such a way that the audit programmes for three to five years cover all types of transactions for the whole year. *For example*, in year 2000-2001, transactions relating to January, June and December are checked in year 2001-2002, transactions covering the months of February, May and July are checked in year 2002-2003 transactions were selected from the months of March, August and November and so on.
- (v) **Study the processing of a transaction in detail** - Procedures for processing a transaction right from the beginning to the end must be studied in a sequential order for transactions selected for test checking. Not only the procedures should be studied, but also the objective of each check at any point in the transaction cycle should be clearly understood by the audit staff. *For example*, every purchase of goods should be properly requisitioned and ordered, goods received should be in a good condition and the amount paid for them should match the amount on vendor invoice.

#### 5.4-4 Advantages

- (i) Test checking saves time and energy.
- (ii) It helps in reducing the cost of audit.

#### 5.4-5 Disadvantages

- (i) **All errors or frauds may not be detected** - Test checking is based on the selection of representative sample of transaction. The possibility of detection of all errors or frauds is, therefore, reduced.
- (ii) **Difficulty in determining the sample size** - It does not provide for any scientific technique for determining the size of the sample to be selected. Hence, the sample selected may not be representative.
- (iii) **Does not measure the risk element in checking** - There should always be a measure of risk (called confidence level) associated with results drawn on the basis of a sample and extended to universe. But in test checking the risk element in checking cannot be measured.
- (iv) **Unsuitable for small businesses** - Test checking is unsuitable for small businesses because the sample selected may not be representative.

#### Test checking and Audit-in-depth

**5.4-6** Audit-in-depth implies a detailed and step by step examination of transactions through its processes of the activity from origin to the conclusion. In other words, it involves a comprehensive checking. Audit in depth is closely associated with test

checking. The transactions selected at random in test checking are subjected to audit in depth.

### Test checking and Routine checking

5.4-7 Both test checking and routine checking are forms of audit examination. To understand the relationship between the two it is important to understand routine checking first.

- (i) **Concept** - The checking of certain records and books viz, books of original entry, ledgers and trial balances, which are common to all types of businesses, by the auditor is called routine checking. It normally involves:
  - (a) Checking of castings, sub-castings, carry-forwards and other calculations in the books of original entry.
  - (b) Checking of posting into the ledger.
  - (c) Checking of casting and balancing of various accounts in the ledger.
  - (d) Checking of transfer of balance from ledger to trial balance.
- (ii) **Objectives** - The objects of routine checking are :
  - (a) Verification of arithmetical accuracy of the entries in original books and ledgers.
  - (b) Ensuring posting from books of original entry to the correct accounts in ledgers.
- (iii) **Advantages**
  - (a) Helps in ascertaining the arithmetical accuracy of the accounts.
  - (b) Early detection of frauds and errors of simple nature.
  - (c) Being a simple job, it can be done by a person with ordinary knowledge of accounts.
- (iv) **Disadvantages**
  - (a) Causes monotony in the staff performing it because of its mechanical nature.
  - (b) Does not reveal compensatory errors and errors of principle. Only clerical errors can be easily detected through routine checking.
  - (c) Only minor cases of frauds can be detected.

Although there are certain disadvantages associated with routine checking, the importance and utility of routine checking cannot be overlooked. It forms the basis of further detailed checking. Therefore, it should be done very intelligently and carefully.

- (v) Test checking and routine checking can be **distinguished** on the basis of following points :
  - (a) **Concept** - Test checking involves selecting a *few transactions* on the basis of auditor's judgment *and examining* them. But routine checking involves *checking of books and records*.
  - (b) **Object** - The main object of test checking is *to form an opinion* on the financial statements on the basis of examination of selected sample. While the main object of routine checking is *ensuring arithmetical accuracy* of the entries in the original books and ledgers and *posting to correct ledgers accounts*.

- (c) **Relationship** - Routine checks may be performed on the basis of test checking.

**5.4-8 Auditor's duty regarding test checking**

- (i) Auditor uses test checking to reduce cost and save time.
- (ii) Use and extent of test checking is dependent upon the system of internal check in operation for business.
- (iii) Certain safeguards should be taken to ensure reliability of results of test checking such as the sample selected should be representative, the selection of sample must be done on a random basis, the selection of sample must be done on a random basis, ensure complete coverage of transactions, etc.
- (iv) Test checking should be carried out intelligently and carefully, otherwise it may lead to dangerous consequences. If done negligently, the auditor may be held responsible for subsequent discovery of frauds and errors.