

**SCHOOL OF STUDIES IN COMMERCE**  
**VIKRAM UNIVERSITY, UJJAIN (M.P.)**

**CLASS:** B.B.A. (HONS.) 4<sup>TH</sup> SEM.

**SUBJECT:** CORPORATE AUDITING

**TITLE OF LECTURE:** TEST CHECKING

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# ***TOPICS***

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# TEST CHECKING

## **MEANING**

Examination in Depth means examination of a few selected transactions from the-beginning to the end through the entire flow of the transaction. It involves studying the recording of transactions the various stages through which they have passed:

### **1. Aspects of Verification**

(a) At each stage, relevant records and authorities are examined; it is also judged whether the person who has exercised the authority in

Relation to the transactions is fit to do so in terms of-the prescribed procedure.

(b) While auditing in depth, the Auditor reviews all the accounting and operational aspects of the transaction from the origin to the end. This enables him to have an overall view and evaluate the procedures through selected transactions.

**2. A Representative Sample** must be open and each item selected must be traced meticulously.

**3. A smaller number of transactions** are checked at each Successive stage with a in-depth test, on statistical grounds (based on probability theory) that the optimum sample size decreases as the Auditor's "level of confidence" concerning the functioning of the system increases.

**4. Examination in depth** reconstructs the audit trail and reveals more about the functioning (or malfunctioning) of the client's system in practice than the haphazard and mechanical approach to testing.

**5. Example:** Audit in depth of transactions relating to purchase of Goods involves verification of the following:

- (a) Purchase Requisition - pie-printed, pre-numbered and authorized;
- (b) Invitation of quotations and analysis of the same;
- (c) Official Purchase Order, sequentially pre-numbered, authorized and placed with approved suppliers only;
- (d) Receipt of goods, together with Delivery Challan / Advice Note;
- (e) Admission of goods to stores after verification of quality, quantity etc.;
- (f) Entry in Stores Records;
- (g) Receipt of Supplier's Invoice and Statement;
- (h) Approval of Purchase Invoice regarding compliance for specification, quantity and quality;
- (i) Entries in Purchases day book;
- (j) Postings to Purchase Ledger and Purchase Ledger Control Account;
- (k) Payment of Cheque in settlement of invoice after availing discounts; if any;
- (l) Entry for payment in Cash / Bank Book;
- (m) Posting from Cash Book to Ledger and Control Accounts.

1. Test Checking means to select and examine a representative sample

from a large number of similar items.

2. Test Checking is an accepted auditing procedure wherein instead of

checking all transactions, only a part of it is checked in detail to form an opinion on the whole.

## ***FEATURES OF TEST CHECKING***

Test checking consists of selecting and checking a proportion of transactions selected by the Auditor. The salient features of Test Checking are –

**1. Scientific:** It is a mathematical truth that a scientifically selected sample would reveal the features and characteristics of the population. The statistical theory of sampling is based on a scientific law. Hence, it can be relied upon to a greater extent than any arbitrary technique which lacks basis and acceptability.

**2. Estimation Process:** Test Checking and Sampling can never bring complete reliability; it cannot give accurate results. It is a process of estimation. What error is tolerable for a particular matter under examination is a matter of the individual's judgment in that particular.

**3. Coverage of material items:** Entries involving large amounts or relating to material accounts are seen exhaustively and other entries are picked up for verification from the remainder according to a certain plan. Sometimes entries are checked for a few specified months exhaustively and the rest go unchecked.

**4. Full Coverage over a time period:** Test Check is normally planned in such a way that the audit programmes for 3 to 5 years cover all types of transactions in case of a medium or large sized Company. Thus, if in one year the months of January, June and December are checked; April, July and September may be checked in the second year and so on.

**5. Surprise Element:** The staff and management of the Auditee Company should not be able to anticipate the pattern of test checking, otherwise they will predict the areas and periods to be covered in any one year and will be careful regarding the same.

**6. Flexibility:** If test checking becomes routine, predictable and mechanical, it loses its value. Hence, the Auditor should keep changing the methods of test checking at reasonably frequent intervals.

**7. Judgment Based:** The extent of test checking would primarily depend on the Auditor's judgment of a particular situation. This judgment in turn depends on the previous experience of the Auditor, current developments and the efficacy of Internal Control System.

### ***FACTORS TO BE CONSIDERED***

The factors to be considered for deciding upon the extent of checking on a sampling plan are -

1. Size of the organization under audit.
2. State and efficacy of the internal control.
3. Adequacy and reliability of books and records.
4. Tolerable error range.
5. Degree of the desired confidence.

### ***WHEN TEST CHECK CAN BE USED?***

Test checks can be adopted in the following cases -

**1. Volume of Transactions:** In case of big concerns where number of transactions is quite large.

**2. Time factor:** Where the Auditor has very little time at his disposal to check all the transactions of a medium or large sized concern.

**Identical Transactions:** When there are a number of transactions of identical and homogeneous nature.

**Internal Control:** When there exists a satisfactory internal control system, manual and / or computerized.

### ***ADVANTAGES OF TEST CHECKING***

The advantages of Test Checking include -

**1. Audit Objective:** The Auditor is required to form an opinion on the Financial Statements. Even after 100% checking, he may not derive absolute satisfaction. Hence, proper and careful test checking serves the audit objective in obtaining reasonable audit assurance.

**2. Expertise:** Application of test check principles involves the application of mind and intelligent judgment. It enables the Auditor to use his expertise effectively.

**3. Exception Principle:** Test Checking adopts the principle of exception in control. If certain aspects of internal control do not create suspicion, there is no need to verify all those transactions

exhaustively.

**4. Scientific Assessment of Risk:** The Auditor assesses the risk of material misstatements in the Financial Statements in a scientific manner by drawing suitable samples and studying the same in detail.

**5. Saving in time:** As fewer transactions are verified, time is saved to a great extent. This, in turn, enables completion of all the audits / verification procedures in time.

**6. Reduction in Work:** Volume of work is reduced by test checking methods. Audit processes are not carried out mechanically on all transactions.

### ***DISADVANTAGES OF TEST CHECKING***

The disadvantages of Test Checking are –

**1. Naive and Biased:** The extent to which test checking can be resorted to is a matter of Auditor's personal assessment. It does not ensure selection of representative samples of adequate size and offers opportunities for bias to enter into selection process.

**2. Unauthentic :** Test Checking lacks authenticity, precision and an acceptable basis. It does not give the Auditor an idea about the degree of reliability that can be placed on the findings for application to the whole set of entries.

**3. Higher Risk:** Test checking runs the risk that some of the



material error may not be discovered and some of the important areas may go unaudited. Sometimes, it may increase the level of inherent Audit Risk.

**4. Unscientific:** It involves lot of arbitrariness on the part of the Auditor in determining and selecting the number of transactions. Therefore, the approach cannot be considered as a scientific one.

**5. Difference in activity levels:** Where activity levels vary in a year, e.g. a few months of peak production and sales seasons, the Auditor cannot draw reasonable conclusions about the transactions of the whole year merely by checking transactions of a few specified months.

**6. Lack of Surprise Element:** If the surprise element is absent, the client may predict the pattern of checking.

### ***TEST CHECKING VS ROUTINE CHECKING***

<b>S.N</b>	<b>PARTICULARS</b>	<b>TEST CHECKING</b>	<b>ROUTINE CHECKING</b>
<b>0.</b>			
<b>1.</b>	<b>Meaning</b>	Test checking is an accepted auditing procedure wherein only a part of its transactions is	Routine checking is the detailed checking of all transactional aspects such as casts, sub – casts, carry forwards, extensions

		checked to form an opinion instead of checking the transactions.	and calculations etc. in subsidiary books, checking of posting into the ledgers, casting of ledger accounts and extraction of their balances etc.
2.	<b>Objectives</b>	To obtain a reasonable level of satisfaction about all transactions but verifying a few representative transactions called "sample".	(a) to verify the arithmetical accuracy of the entries, (b) to verify the accuracy of posting to ledgers. (c) to check that the ledger accounts have been correctly balanced, and (d) to ensure that no figures are altered after checking.
3.	<b>Advantages</b>	(a) Saving in	(a) Checking of

		<p>time.</p> <p>(b) Proper and careful test checking is helpful &amp; serves the audit objective.</p> <p>(c) Volume of work is reduced.</p> <p>(d) Time available for other audits.</p>	<p>posting and ledgers.</p> <p>(b) Arithmetical accuracy can be checked.</p> <p>(c) Trial balance tallying is facilitated.</p> <p>(d) Easy detection of errors and frauds.</p> <p>(e) Delegation of audit work to junior staff.</p>
4.	<b>Disadvantages</b>	<p>(a) Client staff may become careless.</p> <p>(b) Some errors and frauds may go undetected.</p> <p>(c) All items and transactions are not checked.</p> <p>(d) An elements</p>	<p>(a) Is a highly mechanical process.</p> <p>(b) Monotonous activity may lead to boredom.</p> <p>(c) Major items of frauds and high level intricacies and complexities</p>

		of doubt and risk is present in the Auditor's opinion.	may not be revealed. (d) Compensating Errors and Errors of Principle will not come to light.
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