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SURPRISE CHECKS*

1. The Council wishes to bring to the attention of members the importance of surprise checks as a part of normal audit procedures. Audit procedures cannot consist merely of any set of rules or precepts, to be applied to all and every situation but must be allowed to develop in the light of experience with regard to the circumstances of each audit. An element of surprise can significantly improve the effectiveness of an audit and therefore, wherever practicable, an element of surprise should be incorporated into the audit programme.

2. The element of surprise in an audit can be both with regard to the time of the audit, that is the selection of the date at which the auditor visits the client's office to carry out the audit and the selection of the items which are subjected to audit.

3. Surprise checks are mainly intended to ascertain whether the system of internal control is operating effectively and whether the accounting and other records are prepared concurrently and kept up-to-date. It has often been found that manipulations and frauds are facilitated under a system of book-keeping which does not give proper emphasis to the need to keep the books up-to-date. Errors in book-keeping are often indicative of weaknesses in internal control which may be taken advantage of in order to perpetrate frauds or manipulations. Surprise checks are a useful method of determining whether or not such errors exist and where they exist, of bringing the matter promptly to the attention of the management so that corrective action is taken immediately. Consequently, surprise visits by the auditor can exercise a good moral check on the client's staff.

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4. While surprise checks would generally be appropriate in most cases, they are particularly appropriate in cases where the auditor is not satisfied with regard to the system of internal control, or where the company is a very large one or has diversified activities or numerous branches, leading to remoteness of control between top management and various persons in charge of the company's operations at different locations. Surprise checks are also particularly relevant in respect of certain items, for example, cash, investments, stores and stocks, statutory registers normally required to be examined for the purposes of audit, etc. They also have great relevance to ensure that the books of prime entry, for example, the cash book, sales and purchase journals etc., have been kept up-to-date. When EDP system is being used, surprise checks, through the use of test-checks etc., are important to ensure that the programmes are operating satisfactorily.

5. The need for and frequency of surprise checks is obviously a matter to be decided having regard to the circumstances of each audit. It would depend upon the extent to which the auditor considers the internal control system as adequate, the nature of the clients' transaction, the locations from which he operates and the relative importance of items like cash, investments, stores etc. However, wherever feasible, a surprise check should be made at least once in the course of an audit.

6. In the case of an audit of a company, the auditor is appointed at the Annual General Meeting to hold office until the next Annual General Meeting. He is not appointed for a particular accounting year. Consequently, he has the right of examination of the accounts and records of the company at any time during the period covered by his appointment, in so far as it is necessary for the purposes of his report. He may, therefore, carry out surprise checks of transactions beyond the end of the accounting year for which he is reporting.

7. Surprise checks are a part of the normal audit and the results of such checks are, therefore, important primarily to the auditor himself in deciding the scope of his audit and submitting his report thereon. If the surprise check reveals a weakness in the system of internal control or any fraud or error or the fact that any book or register has not been properly maintained or kept up-to-date, the auditor should communicate the same to the management and ensure that action is taken on the matters communicated by him. It does not necessarily follow that all or any of the matters communicated to the management should form part of the auditor's report on the accounts.

Whether the items should also be included in the auditor's report on the accounts is a matter for each auditor to decide in the light of the circumstances of each case. In arriving at his decision he must consider, *inter alia*, the magnitude of the amounts involved, whether the errors or deficiencies pointed out have been rectified or the weaknesses in the internal control system corrected and the extent to which the accounts reported upon are affected by the matters stated by him in his report to the management.

8. The Council, therefore, makes the following recommendations:

(i) Surprise checks should be considered as a desirable part of each audit.

(ii) The areas over which surprise checks should be employed would depend upon the circumstances of each audit but should normally include:

   (a) Verification of cash and investments.

   (b) Test-verification of stores and stocks and the records relating thereto.

   (c) Verification of books of prime entry and statutory registers normally required to be examined for the purposes of audit.

(iii) The frequency of surprise checks may be determined by the auditor in the circumstances of each audit but should normally be at least once in the course of an audit.

(iv) The results of the surprise checks should be communicated to the management if they reveal any weakness in the system of internal control or any fraud or error or deficiency in the maintenance of records.

(v) The auditor should satisfy himself that adequate action is taken by the management on the matters communicated by him.

(vi) It is not necessary in all cases for the results of the surprise checks to be included in the auditors' report on the accounts. They should, however, be included if in the opinion of the auditor they are material and affect a true and fair view of the accounts on which he is reporting.