**Inventory Count Program**

Guidelines for observation of physical inventories

* 1. As per the requirements of ISA 501, if inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by attendance at physical inventory counting, unless impracticable.
  2. The purpose of attending the physical inventory counting is to determine that the client’s instructions and procedures result in an accurate count. It should be remembered that while the auditor will himself carry out test counts and extract certain cut-off information he is primarily there to observe that the client’s instructions and procedures are satisfactory.
  3. Where the client has an efficient system for inventory records, the physical inventory count may be carried out on a continuous basis as opposed to counting everything in one go at the year-end. In the case of a client using the continuous basis, the auditor will still be required to observe a part of this continuous inventory counting.
  4. The work of the auditor will normally cover three stages – before, during and after the physical inventory count.
  5. The following tasks should be carried out before the physical inventory count begins:

1. Obtain a copy of the client’s inventory instructions.
2. Review adequacy of instructions using the pre-printed checklist and discuss any weaknesses in instructions with the client.
3. Arrange for confirmation letters to be sent to third parties holding inventories on behalf of client, requesting confirmation of these inventories to be sent direct to the auditors with a copy to the client.
   1. The main task during the count is to see that the client’s employees are carrying out their instructions and performing procedures properly.

The physical inventory count pre-printed checklist should be completed and supporting schedules will be prepared to cover the following:

1. Notes of inventory movement during the count.
2. Details of last number prior to physical inventory count in respect of:
3. Goods received
4. Goods despatched
5. Internal movement of goods
6. Details of numbering of inventory sheets used and destroyed and of control of their issue to and return by those carrying out the physical inventory count.
7. Schedules of items counted by the auditor showing their valuation (this valuation may have to be completed at final visit).
8. Details of any old, obsolete, damaged or excess inventories noted during the attendance.
9. Comments on adequacy of custody.
   1. The working paper should be prepared in such a manner that the information can be easily followed up at the final audit visit. Test counts for example should have been traced to the stock sheets to confirm that they are a proper record of the results of the physical inventory count.
   2. The auditor should be aware of the approximate value of the various inventory items as he may wish to cover high value items in his test count. The valuation of the items counted by the auditors should be recorded during the count or, if not possible, at the final audit visit.
   3. Where it is considered that physical inventory count has been unsatisfactory in any major respect that matter should be reported immediately to the manager or partner concerned so that the necessity for a second physical inventory count can be considered and discussed with the client.
   4. At the final audit, the information obtained at the physical inventory count will be followed up. The work to be carried out will include:
10. An overall review of the working papers to assess the effectiveness of the physical inventory count and whether the final audit program work should be altered as a result.
11. A check of the cut-off using the information obtained or the last goods received and despatched note numbers.
12. A check of the auditor’s test count items to the final inventory sheets.
13. A test that the final inventory sheets include only the inventories counted by reference to the details of numbering of inventory sheets obtained during the observation.
14. A follow up of all outstanding queries including obsolete etc. items noted at the attendance of the physical inventory count.
15. A test to ensure that inventory records have been adjusted to agree with the physical inventory count.
16. A discussion with management of any weakness which arose, and if appropriate include points in the internal control memorandum.

Inventories

|  |  |
| --- | --- |
| **Name of Client** | **${client}** |
| **Location or Department** |  |
| **Date(s) of Inventory Taking** |  |
| **Date(s) of Observation** |  |
| **Firm Representative(s)** |  |
| **Client representatives in charge of inventory (or department)** |  |

**Objectives:** The purposes of the physical inventory observation are to determine that:

1. The inventory actually exists;
2. The methods of inventory taking are effective in obtaining accurate counts, and
3. The inventory is in a usable and salable condition in the normal course of business (e.g., not damaged or obsolete).

**Assertions:** E/O, C, V/A

**Instructions:**

This checklist covers information obtained and audit techniques usually employed during a physical inventory observation, including tests of perpetual inventory records. The checklist is not an exhaustive list of considerations for all observations. It should be supplemented by additional instructions and procedures whenever appropriate.

Some questions may be inappropriate for some observations. Questions that do not apply should be designated N/A (not applicable). A "no" answer should be explained in an attachment referenced to the related question.

An inventory count has three stages:

1. Organization
2. Conduct
3. Follow-up

Such counts are carried out by business either:

1. To corroborate information contained in their books and records which is the product of a continuous accounting and control system, or
2. To provide an inventory figure for inclusion in financial statement and to use in calculating profit where there is no system of continuous inventory accounting.

Attendance at inventory counts by the auditor is a standard verification test which serves to confirm the physical existence of inventories, to corroborate the method of quantification and to ascertain their physical condition.

The staff member is required to:

1. Observe compliance with instructions and procedures and complete the following checklist.
2. Carry out test counts as specified by the scope decisions sheet and record the results on the sheets attached to the checklist.

**General description of inventory:**

|  |  |
| --- | --- |
| **Type of inventory (indicate those that apply):** | |
| Raw materials |  |
| WIP |  |
| Finished goods |  |
| Wholesale and/or retail merchandise |  |
| Other (i.e., supplies, repair parts, etc.) |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Special categories of Inventory (if "yes" obtain particulars for audit follow-up):** | | **Yes** | | **No** | |
| On-site | Goods billed not shipped | |  | |  |
| Goods received not billed | |  | |  |
| Inventory owned by others | |  | |  |
| Consignments in | |  | |  |
| Off-site | Goods in transit to customers | |  | |  |
| Goods in transit from vendors | |  | |  |
| Inventory held by others | |  | |  |
| Consignments out | |  | |  |
| Special classes | Obsolete | |  | |  |
| Overstock | |  | |  |
| Slow moving | |  | |  |
| Special order | |  | |  |
| Damaged | |  | |  |
| Discuss with client personnel and describe particulars for any classes listed above: | | | | | |
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**Checklist:**

|  |  |  |  |
| --- | --- | --- | --- |
| **Question** | **Yes** | **No** | **Alternative procedure** |
| **Organization** | | | |
| 1. Were adequate written instruction prepared covering each phase of the physical inventory procedures, issued in advance of the count and used (describe issues noted if any). Consider the following in evaluating their adequacy:  * Plans for arranging and segregating inventory, including precautions taken to clear work-in-process to cutoff points. * Provisions for control of receiving and shipping during inventory taking period and, if plant is not shut down, provisions for handling inventory movements. * Instructions for recording description of items and how quantities are to be determined (e.g., count, weight, state of completion of WIP, or other measurement). * Instructions for identifying obsolete, damaged, and slow-moving items. * Instructions for use of inventory tags or count sheets (including their distribution, collection, and control). * Plans for determining quantities at outside locations. * Instructions for review and approval of inventory counts by department heads or other supervisory personnel. * Instructions to determine that packaged contents match description of inventory. * Instructions for inventory items to be recounted by persons other than those making the original counts. |  |  |  |
| 1. Was there adequate physical preparation for the count including:  * Tidying up. * Stopping work or production. * Sorting gods out. * Identifying and marking goods. |  |  |  |
| 1. Were stock sheets prepared before the count. |  |  |  |
| 1. Was cut-off proper organized by:  * Closing receiving and dispatch. * Recording the last numbers of documents controlling the flow of goods prior to the count. * Segregating goods in receiving and despatch areas. |  |  |  |
| **Conduct** | | | |
| 1. Was the count carried out by personnel:  * Not usually involved in the custody of inventories. * Able to identify the inventories being counted. |  |  |  |
| 1. Was a system of double check carried out by accounts or supervisory personnel. |  |  |  |
| 1. Were inventories marked as counted to avoid omission or duplication in the count. |  |  |  |
| 1. Were damaged or obsolete items specifically noted. |  |  |  |
| 1. Were the contents of sealed packages checked by opening and weighed to see that contents conformed to labels. |  |  |  |
| 1. Was there an adequate procedure to identify goods not belonging to the company. |  |  |  |
| 1. Where amendments to inventory sheets were made were these initialed by a supervisor. |  |  |  |
| **Follow-up** | | | |
| 1. Were all the inventory sheets accounted for. |  |  |  |
| 1. Were rough inventory sheet retained. |  |  |  |
| 1. Is there a proper procedure for authorized amendment of inventory record to agree to the results of the count. |  |  |  |
| 1. To assist in testing cut-off, try to establish and note down the last goods received and issued prior to the physical inventory, and the last transfer between categories of inventory. |  |  |  |

**Conclusion:**

Give below your overall conclusions on the count referring specifically to:

1. The adequacy of instructions and procedures laid down.
2. Whether these instructions and procedures were complied with, and
3. Whether the results of the counts can be relied upon the properly reflect quantities on hand as of that date and to form the basis of the valuation of inventories.

Document any identified control issues related to the client’s physical inventory count instructions and procedures.

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Signed

Client

Date of count

**Record of Test Counts:**

Selection of items in both directions (full and false inclusion).

|  |  |  |  |
| --- | --- | --- | --- |
| **Reference (stock sheet number etc.)** | **Description of item** | **Quantity counted** | **Condition (i.e. note any damage or obsolescence)** |
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