

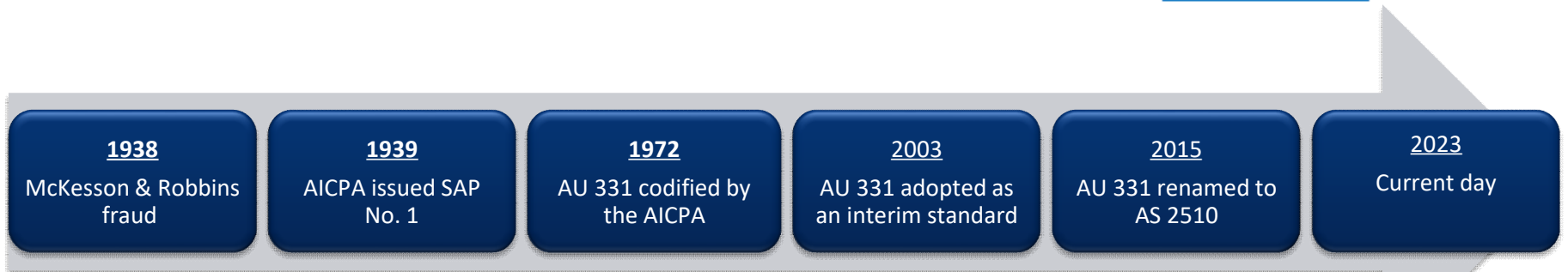
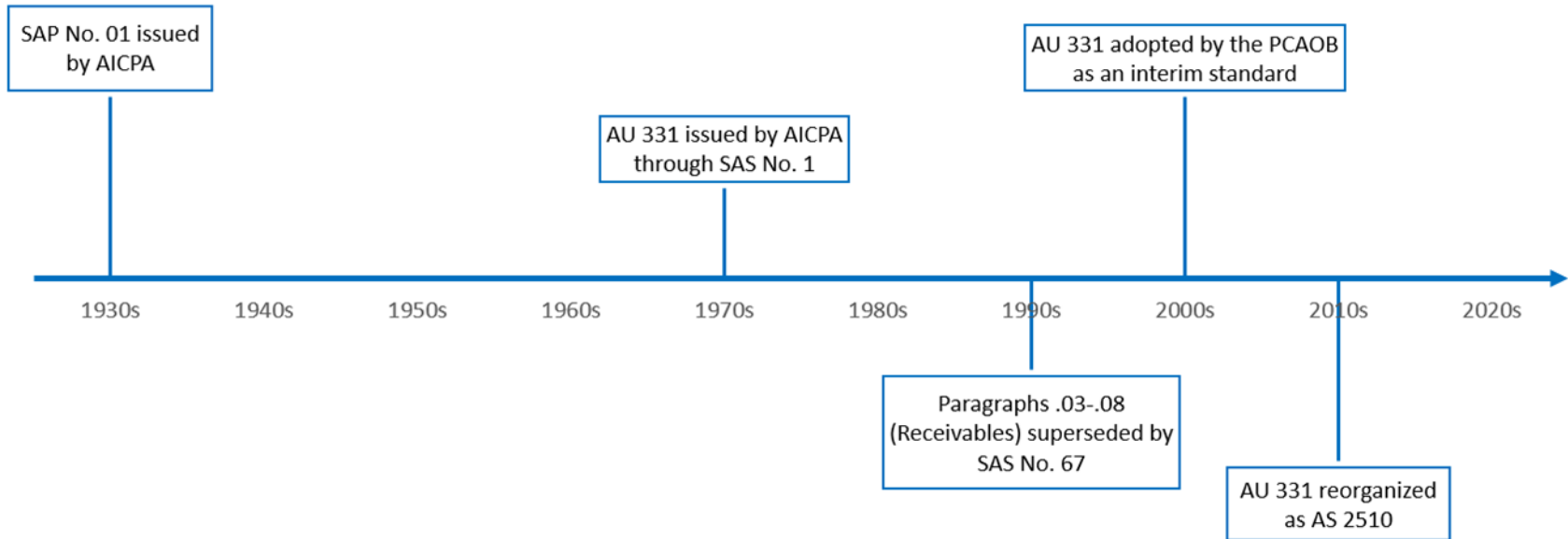
Auditing Inventories

Office of the Chief Auditor
PCAOB SEIAG Meeting
November 2, 2023

AGENDA

- Background
 - History of auditing inventories
 - Summary of AS 2510
- Topics for discussion

HISTORY OF AUDITING INVENTORIES



No substantive changes to the auditing requirements in 84 years

SUMMARY OF AS 2510

Paragraphs .01-.02

- .01 Observation of inventories is a generally accepted auditing procedure
- .02 Purpose of AS 2510 is to provide guidelines for the independent auditor in observing inventories

Paragraphs .03-.08 *Receivables* (deleted and incorporated into AU 330, *The Confirmation Process*)

Paragraphs .09-.13 *Inventories*

Describes nature and timing of audit procedures for situations where inventory is counted only at year end, and for situations where well-kept perpetual records are maintained and periodically compared to physical counts.

Establishes that tests of accounting records alone are not sufficient. It will always be necessary for the auditor to make, or observe, some physical counts and test intervening transactions. For prior periods in which the auditor has not observed, other tests may be performed.

Paragraph .14 *Inventories Held in Public Warehouses*

For inventories representing a significant proportion of current or total assets in public warehouses or held at a custodian, in addition to a direct confirmation, the auditor should apply one of the following: (1) testing owner's procedures for investigating and evaluating warehouse staff, (2) obtaining an independent accountant's report on warehouse control procedures, (3) observing physical counts, or (4) for receipts pledged as collateral, confirming details of pledged receipts with lenders.

Paragraph .15 *Effect on the Auditor's Report*

References AS 3105.07 and .51 for circumstances affecting the auditor's report

TOPICS FOR DISCUSSION

- Observation of inventory and related auditing procedures
- Advances in technology in reporting and auditing of inventory
- Use of a third-party in the inventory process
- Key inventory-related matters discussed with audit committees

OBSERVATION OF INVENTORY AND RELATED AUDITING PROCEDURES

1. Observation of inventory is a generally accepted auditing procedure to obtain audit evidence over inventory recorded in a company's financial statements. In your experience, are there other, even potentially more effective, auditing procedures to obtain audit evidence over the existence and condition of inventory? Are there circumstances where an inventory observation may not be necessary?
2. When an inventory observation is performed, are there questions in practice about the extent of the physical observation procedures required? If so, what are they?
3. We intend to adopt standards that are scalable for all audits based on their nature and circumstances. To promote this, how could the standard be better integrated with the auditor's risk assessment?

ADVANCES IN TECHNOLOGY IN REPORTING AND AUDITING OF INVENTORY

4. How is technology being used today or will potentially be used in the future for inventory observation (e.g., drones)? Could virtual observations completely substitute for in person attendance, or should they be used in combination with attending inventory counts in person?
5. Some audit strategies include the performance of virtual inventory counts. Are there additional risks present when observing inventory virtually beyond what is mentioned above and if so, what are they. How can the risks sufficiently be overcome?
6. Where virtual inventory counts are performed (that is, there is no physical presence by an engagement team member), what additional procedures, if any, are performed to verify the existence and condition of physical inventories?

USE OF A THIRD-PARTY IN THE INVENTORY PROCESS

7. Where inventory is held at a third-party custodian or public warehouse, are SOC reports that address control procedures relevant to the custody and maintenance of such inventory typically available? If not, what other procedures are commonly performed to obtain reasonable assurance with respect to the existence of such inventory?
8. When a company uses a third-party count service to perform the physical inventory count, what procedures are performed by the auditor related to the count service, including any procedures over controls that address the existence and condition of inventory, as well as the completeness and accuracy of count data?

KEY INVENTORY-RELATED MATTERS DISCUSSED WITH AUDIT COMMITTEES

9. Is there information that the audit committee or investors would benefit from knowing about the auditor's decision, e.g., if an auditor does not perform an inventory observation?
10. Are there matters relating to the observation of inventory that are considered in the identification of CAMs? What matters relating to inventory observation, if any, would audit committees and investors expect to see as CAMs?

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