

Key Considerations for Inventory Counts under COVID -19 Situation

This publication has been prepared to highlight principal areas of focus for the auditors when attending the inventory counts in current COVID-19 impacted environment.

This publication is based on the guidance provided in International Standard on Auditing 501 *Audit Evidence - Specific Considerations for Selected Items*. In this publication the terms inventory count and stock-take are used interchangeably.

This publication is aided by a separate **Questions and Answers** document that discusses different scenarios relating to the inventory counts and their implications on the auditor's procedures, communication and audit report. Further, the requirements of ISA 501 relating to the auditor's responsibility to obtain sufficient appropriate audit evidence on inventory are also reproduced in the above-mentioned document for the ease of reference.

Entities, generally conduct inventory counts at or near the financial year-end, and auditors have been attending those inventory counts in person.

However, the COVID-19 health crisis and related conditions have brought in significant challenges for both entities and their auditors. In context of the stock-takes, an entity may find it difficult to organize and conduct an inventory count, or the auditor may not be able to attend the inventory count.

ISA 501 outlines that the auditor should attend the inventory count, where it is practicable to attend and inventory is material to the financial statements. The principal considerations for the auditors to address different implications of the COVID-19 related circumstances and conditions on the auditor's attendance at the physical inventory counting are explained below.

Physical attendance of the auditor at year-end stock-take

The auditor may decide to physically attend the stock-take. The auditor when deciding to attend the inventory count in person should consider the safety of its staff and entity's personnel. Maximum efforts should be made to ensure safety of all, irrespective of the lack of formal restrictions on movement and any government safety instructions.

Virtual attendance of the auditor at year-end stock-take

The auditor can also attend the stock-take virtually (through the use of technology). However, while evaluating the use of technology and during its use to virtually attend physical inventory counting the auditor will have to demonstrate careful planning and heightened professional skepticism. This includes, amongst others, directing the way the observation is conducted as if it was performed physically, being able to see the inventory clearly. The auditor should be mindful that video-conferencing may only allow a restricted view of the location where the inventories are kept, therefore remaining alert to situations where the inventories may be moved around and counted twice. Accordingly, remote attendance for stock-takes must be applied with great care.

In certain scenarios, virtual attendance at the stock-take may not be appropriate. These scenarios could include first-year audits where the auditor has never physically attended observations at the entity before, situations where the auditor has identified material misstatements or deficiencies in inventory records during prior year audit(s), management maintains a periodic inventory system, for observing work-in-progress inventory etc.

Management's refusal to conduct stock-take at year-end

In certain cases, in consideration of COVID-19 risks, entity's management may:

- Disallow auditor's attendance at the yearly inventory count; or
- Refuse to conduct the inventory count at the financial year-end.

Management's refusal to conduct stock-take at year-end - *Continued*

In such cases, the auditor should engage with entity's management to understand the reasons for its inability to conduct the stock-take on the financial year-end or disallowing auditor's attendance. The auditor should use professional skepticism and judgment when evaluating the management's concerns. However, where auditor concludes that management explanations are reasonable, the auditor should not persist to attend management's yearly inventory count (if management decides to perform physical inventory count and refuses to allow auditor's attendance) or request management to conduct an inventory count at the year-end.

The auditor should discuss with management and those charged with governance about the possibility of conducting physical verification at a later date, once health risks are expected to be reduced.

If management refuses to conduct stock-take at year end or an alternate date, the auditor should consider performing alternative procedures and the possible impacts on audit opinion. This scenario would impact the risk assessment and possibly the ability to obtain sufficient appropriate audit evidence through alternative procedures. Where auditor concludes that a scope limitation exists, the matter is communicated to those charged with governance, and if scope limitation is not relieved then it is reported in the audit opinion.

Management conducts stock-take at an alternate date

In current environment, auditor and management may mutually agree on conducting the stock-take at an alternate date, once health risks are expected to be low.

The auditor can attend the stock-take on such alternate date, in person or remotely based on the circumstances, audit approach and cost and effort. In such cases, in addition to attending inventory count the auditor is also required to perform alternative audit procedures. The objective of those procedures would be to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded.

Auditor's arrangement to visit warehouse

Auditor's arrangement to visit the warehouse to conduct tests when the relevant premises are closed and no staff are present will not provide audit evidence relating to inventory counting procedures. Further, the substantive evidence based on sampling procedures would provide limited audit evidence relating to the existence and condition of inventory. This may limit the scope of the audit.

Impracticable for the auditor to attend the stock-take

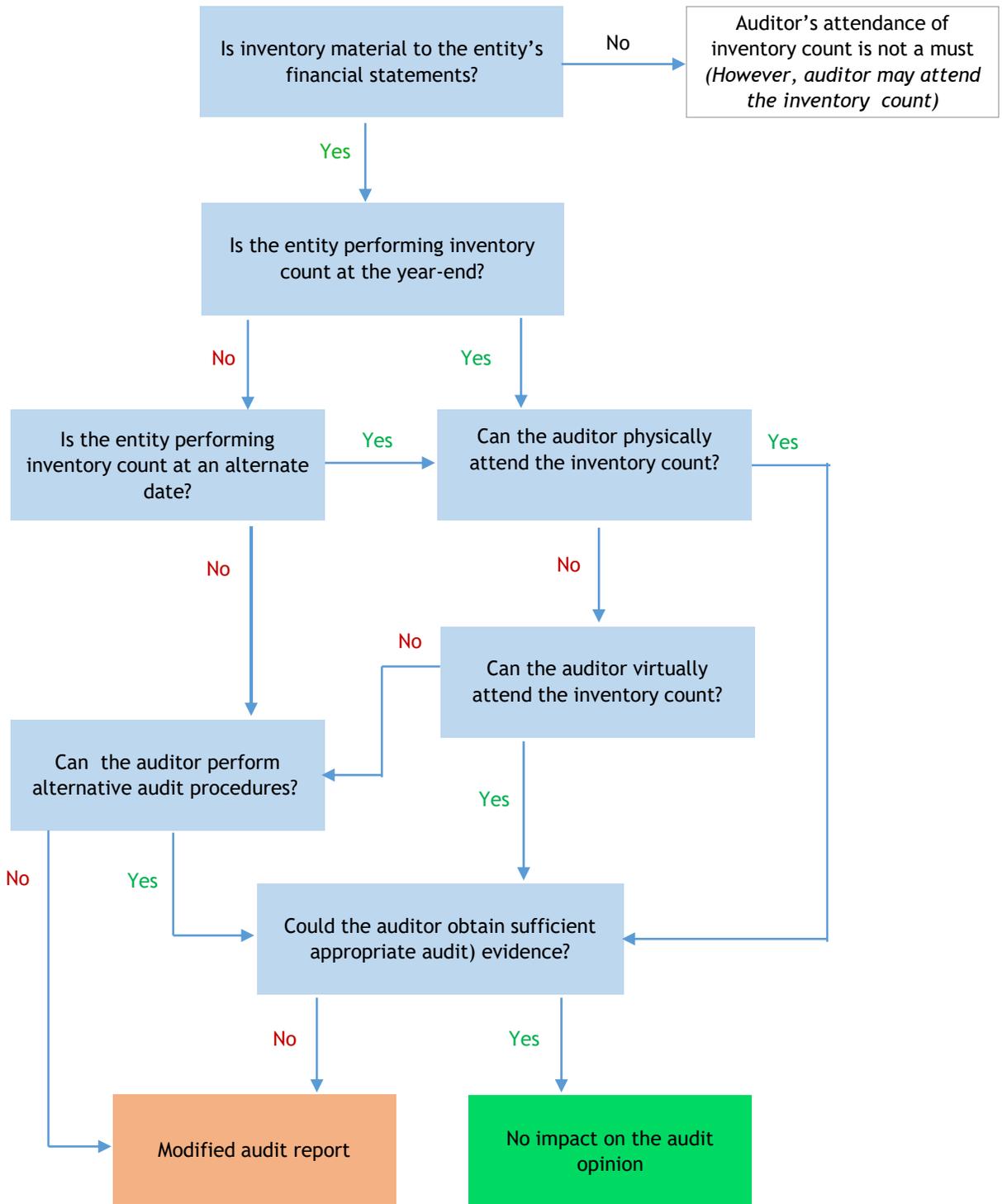
ISA 501 recognizes that in some cases attendance at stock-take may be impracticable for the auditor. In context of COVID-19 health concerns, in certain cases, the auditor may not be able to attend the inventory count (either in person or remotely). ISA 501 does not explain "impracticable" in the context of being unable to attend an inventory count. It, accordingly, explains that the matter of general inconvenience to the auditor, is not sufficient to support a decision by the auditor that attendance is impracticable.

Where the auditor, has not been able to attend the stock-take altogether, the auditor should consider performing alternative audit procedures such as roll-forward procedures based on the last stock-take. The ISAs guide that where attendance is impracticable alternative audit procedures may include the inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, and this may provide sufficient appropriate audit evidence about the existence and condition of inventory.

Possible implication on audit opinion

If the auditor could not attend stock-take or perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory, the auditor is required to consider whether it is appropriate to modify the opinion in the auditor's report (i.e. qualified opinion or a disclaimer of opinion), in accordance with ISA 705.

Decision Tree



Disclaimer

This publication considers the requirements of International Standards on Auditing as applicable in Pakistan. In consideration of current circumstances, the publication outlines some of the key implications and responses for auditor's attendance at inventory counts, however appropriate responses to issues will depend on each audit's unique facts and circumstances. The matters, procedures and examples included in this document are not all-inclusive. Further analysis and judgment would be necessary in order for an auditor to apply the requirements to their own facts, circumstances and clients. For additional details on ISAs you would need to refer to the relevant literature. Further, the information provided in this document is for general guidance only and may change from time to time.