

## **AUDIT UPDATE**

**Physical Inventory Verification-  
Key Audit Consideration Amid  
Covid-19**



## COVID -19 : Physical Inventory Verification

### Background

- Physical verification of inventory is the responsibility of management of the entity. Management is required to establish procedures under which inventory is physically counted at least once a year to ensure existence, condition and support valuation of inventory.
- Further, the Auditor needs to comment over the physical verification of Inventory under The Companies (Auditor's Report) Order, 2016 (**CARO 2016**).
- Additionally, **SA 500 "Audit Evidence"** prescribes that the objective of the auditor is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.
- Due to the difficulties faced by various business entities, the ICAI has come up with the Auditing Guidance on "Physical Inventory Verification for the benefits of the members as on dated 13<sup>th</sup> May 2020.

### Auditors Considerations in various scenarios

The COVID-19 outbreak could create several potential challenges for management of an entity to conduct physical inventory counting and for the auditors to attend these counts. With scenarios like lockdown, travel restrictions etc. as imposed by Government of India, physical inventory counting would be challenging and in some cases it would be impracticable. Possible challenges in this regard are discussed below.

- 1) **There Management unable to conduct physical inventory counting as on the date of financial statements-** In such a scenario, management should inform the auditors and those charged with governance the reasons of not conducting the inventory counting.
- 2) **Physical inventory counting conducted by management at a date other than the date of financial statements-** In Such scenario, the auditor shall apply following procedure.

-Attending inventory counting at an alternative date may involve attending inventory counting at a later date from the date of the financial statements with performing roll-back procedures to the balance sheet date, or, if an inventory counting was conducted by the entity and attended by the auditor at an interim date before the date of the financial statements, it may be possible to use those findings and perform roll-forward procedures to the balance sheet date.

-Auditors should also consider whether the time between the balance sheet date and the date of the inventory counting being performed reflects the appropriate assessment of the physical condition of inventory.

- 3) **Alternative audit procedures where it is impracticable for auditors to attend physical inventory counting-** Due to various restrictions imposed due to COVID-19 outbreak, in certain cases it could be impracticable for auditors to physically attend the inventory counting. In such cases, the auditor would need to comply with the procedures given in paragraph 7 of SA 501 read with paragraphs A12 to A14 of SA 501. These paragraphs are given below:

*“If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor shall modify the opinion in the auditor’s report in accordance with SA 705(Revised)” (Ref: Para. A12-A14).*

#### **Different Alternative Audit Procedure**

- (1) **Using the work of internal auditor-** the external auditor can use the work of internal auditor regarding inventory verification.
- (2) **Engaging other Chartered Accountant(s) to attend physical verification-** Where due to lockdown restrictions imposed by the Government, the auditor is not able to attend the physical verification of inventory, the auditor in discussion with the management may appoint other Chartered Accountant(s), who is resident of the location of the entity’s warehouse/ factory/ inventory, to observe the physical counting.

- (3) **Use of technology in inventory counting-** In certain situations where physical attendance by auditors at inventory counting is not possible, they may be able to observe the inventory counting remotely via video call with the help of technology. Auditors would need to ensure the security on these applications.
- (4) **Inventory held by a third party-** Where the entity has inventory under the custody and control of a third party, it may be possible, in accordance with SA 501 to place reliance on confirmation received from that third party regarding the quantities and condition of the inventory held on behalf of the entity.
- (5) **Inventory in transit / cut-off procedures-** Due to the lockdown situation, it might be possible that inventory purchased or sold might be locked up in transit. Auditors should obtain suitable audit evidence regarding the location and condition of the inventory including documentary records about purchases/sales. Appropriate cut-off procedures need to be employed to ensure appropriate quantities are considered in the inventory.

**ICAI has come up with the Auditing Guidance on “Physical Inventory Verification – Key Audit Considerations amid COVID 19” on 13th May 2020 for the benefits of its members.**

**For more details please refer the link: <https://resource.cdn.icai.org/59498aasb48418.pdf>**

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