Inventories - Outline program

I Physical counts

Advance preparation

1) Obtain a complete list of inventory locations and aggregate amounts at each location

2) Obtain a draft of the physical inventory instructions sufficiently in advance of the inventory date to discuss with the client any necessary revisions. Review proposed inventory-taking procedures and count instructions. Discuss with the client any potential problem areas or apparent weaknesses.

3) Tour plant areas in advance of physical inventory to assess stock layout and areas that may require special attention during the physical inventory.

4) Obtain a list of:

\* departments or areas

\* names of department heads

\* number (sequence) of tags or count sheets issued to each department

\* latest available inventory amounts in each department

5) Determine the number of test counts to be made and recorded by us for each department and area, giving consideration to the client's inventory procedures and control over inventory taking.

6) Familiarize staff with any carry-forward data and special problems.

Observation of client procedures

7) Observe count teams in action, noting adherence to instructions, care in making counts and care over accurate and complete recording of descriptions or stage of completion of in-process inventories (e.g., last operation number).

8) Note that count teams systematically cover assigned areas to ensure complete coverage, without overlapping areas that are the responsibility of others.

9) Observe that all materials in areas adjoining the primary storage areas, including railroad cars, truck storage, tanks, etc., have been properly included in or excluded from the inventory count.

10) Ascertain that count teams deal with physical movements in a manner that will avoid duplicate counts or exclusion from the count.

11) Determine that the part number, description and last operation number of manufactured parts selected for count are correct by referring to part numbers stamped on the material or requesting identification by client personnel.

12) Ensure that the count teams open some sealed cartons or containers to determine the quantity and type of contents (i.e., identity, model number, physical characteristics, etc.) and agree these to the description on carton or container.

13) Ensure that count teams watch for empty boxes, spaces in the middle of stockpiles, etc.

14) When appropriate, ascertain that the client compares counts with perpetual records and investigates immediately any large differences.

15) Observe that count teams are noting seemingly excessive, slow-moving or damaged inventory for later review.

16) Ascertain that consigned inventory or previously scrapped materials are omitted from the physical inventory taken by the count teams.

Testing by auditor

17) Select and count certain pallets, bins, piles or stacks of material and compare the count with the client's count, description, last operation and other data on completed tags. Record sufficient detail to enable exact matching with inventory summaries at a later date.

18) Test count with the client's count teams and make sight test comparisons of other pallets, bins, etc., of the same or similar products.

19) Where appropriate, make a selection of inventory products (chemicals, oil, etc.) and send to an outside laboratory for analysis and comparison to actual inventory.

20) Note seemingly excessive, slow-moving or damaged items for later review.

21) To the extent that previously referred to procedures or other required procedures are not carried out effectively by client count teams, perform or re-perform the procedure.

Completion

22) After completion of the count make a final tour of the area, preferably with a department head, and note that:

\* all inventory is tagged or listed

\* any significant amount of obsolete, slow-moving, excess, damaged or unusable inventory has been recorded for later inspection

\* any scrap materials have been counted according to written instructions

23) Record sufficient cut-off data (see additional comments below).

24) Release the area to the person designated in the written instructions to pull the inventory tags or count sheets.

25) Prepare a memorandum for the working papers, summarizing the results of our observations, test counts, etc., and concluding on the effectiveness of physical inventory activities and our degree of satisfaction with them.

II Tag control and false inclusion tests

1) Before the tags or count sheets are sent to the accounting department, prepare or obtain from the client a summary of all tags or sheets assigned to each team, location, department, etc., showing tags or sheets originally assigned, used, unused and voided.

2) Select several groups of tags issued and inspect the tags and document the following in the working papers:

(a) The time and day the tags were authorized to be pulled.

(b) The serial numbers of large blocks of unused tags or count sheets for later testing of the inventory summarization to ensure that they remained unused as a test for false inclusion.

3) Select and record (for later comparison with the final tabulation) a consecutive number of originally issued tags or count sheets and account for all serial numbers, ascertaining that the client has properly recorded them as used, unused or voided.

4) As a precaution against improper ("false") inclusion of tags or lines on count sheets, select several of the "used" tags or count sheets after the client's summary of tags is complete, and locate and count the corresponding material.

III Shipping and receiving cut-offs

1) Visit the receiving and shipping areas and ascertain that employees in those departments understand the procedures to be followed for identifying goods received or shipped immediately before and after the inventory count.

2) Select several receipts and shipments prior to and subsequent to the physical inventory and record the following:

a) Numbers of last receiving reports and a description of the inventory for material that is included in the count.

b) Numbers of last shipping reports or bills of lading and a description of the inventory for goods that have left the plant.

c) Shipping and receiving data sufficient to test the procedures for handling inter-company, inter-division and inter-plant transfer during the inventory count and cut-off period, and data for cross-reference to similar tests made at other plants.

3) Ascertain that related material has been tagged or counted. Ascertain that goods have been shipped and are not set aside awaiting shipment.

IV Cyclic counts

1) Obtain and review client instructions for the selection of items to be counted, physical count procedures and procedures providing assurance of a consistent cut-off between physical inventory and accounting records of receipts, withdrawals and shipments.

2) Compare above instructions and procedures for consistency with those used for the cyclic count(s) observed by the auditor. (Procedures similar to those discussed above should be used to observe the cyclic counts.)

V Inventory held by third parties

When the amount of inventories held by public warehouses or other outside custodians represents a significant portion of current assets or total assets, supplementary procedures such as those listed below should be made to satisfy us as to the validity of the inventory. It may also be advisable to request the warehouse to count the inventory and to observe these procedures.

1) Determine the locations and the approximate value of inventory (by location) of goods owned by the client but not located on its premises.

2) Obtain direct written confirmation of inventory quantities or observe physical counts of the goods.

3) Review the client's control procedures concerning performances of the warehouseman.

4) Where warehouse receipts have been pledged as collateral, obtain confirmation from lenders (on a test basis, where appropriate) about pertinent details of the pledged receipts.

5) By reference to client investigations, credit reports or financial statements, etc., determine that the inventory appears to be in the hands of valid and responsible consignees.

VI Inventory held for third parties

1) Obtain physical inventory listings of quantities held by the client for various consignors. Consider for confirmation:

a) Those consignors where quantities per the consignment records vary significantly from amounts counted at the physical inventory date, and

b) A random selection of consignors, including those with no balance at the physical inventory date but with a large prior year balance and those with material consigned during the year.

2) Arrange for the client to write a letter transmitting the original and two copies of the list to the consignor. Request the consignor to sign one copy and return it directly to the auditor, and to mail the other copy to the client.

Physical inventory observation follow-up

I Physical inventory summarization

1) Obtain final costed physical inventory listings, summaries and reconciliation with general ledger control accounts.

2) Agree control account balances and physical inventory amounts on reconciliation with general ledger and costed inventory listings.

3) Using information obtained at time of physical inventory:

a) Agree test counts to inventory listings, agreeing tag or count sheet numbers, quantity, description, stage of completion (last operation number, etc.) and any other pertinent data.

b) Agree information regarding tag or count sheet numbers used to inventory listings and determine that:

\* tag number sequence is complete

\* void and unused tags or count sheets are excluded

\* no additional counts or lines were added to count sheets.

c) Agree confirmations from (or counts made at) holders of off-premises inventory to listings.

d) Determine that appropriate action has been taken with respect to materials observed during physical inventory to be damaged, obsolete, etc.

4) Agree items selected from final costed physical inventory listings to original company tags or count sheets, etc., agreeing all particulars.

5) Review company tags or count sheets for possible alterations subsequent to physical inventory and fully investigate any indication of changes.

6) Determine whether shipping and receiving cut-offs were properly handled. (See additional comments below.)

7) Agree costs assigned to quantities for selected items to appropriate cost records, suppliers' invoices, etc.

8) For in-process inventories note that cost records (bills of material, product or job cost summaries, etc.) from which assigned costs were taken indicate cost accumulations through stages of completion (last operation number, etc.) which conform to actual stages of completion observed (or reported) during physical inventory.

9) Review inventory quantities and unit costs on inventory lists and summaries for such things as:

a) General reasonableness of inventory by type, category and physical location, when related to knowledge of operations, etc.

b) Reasonableness of unit costs when related to the type of material or product and in comparison to similar materials or products.

c) Possible extension errors (misplaced decimals, etc.)

10) Test mathematical accuracy of inventory listings, summaries and reconciliation to general ledger control accounts.

11) Examine support, as appropriate, for reconciling items and adjustments appearing on the reconciliation.

12) Examine proper approval and recording of book-to-physical adjustments in control accounts and detailed records.

II. Shipping and receiving cut-offs

1. After completion of the physical inventory taking, the cut-off information obtained should be followed-up to ascertain that:

a) Suppliers' invoices for items listed on receiving reports prepared before and after the inventory dates are recorded as accounts payable in the proper period.

b) Sales invoices for items listed on shipping reports or bills of lading prepared before and after the inventory dates are recorded as sales in the proper period.

c) Inter-company, inter-division and inter-plant transfers of inventory have been properly accounted for at both locations.

III Cyclic counts

1. Obtain results of cyclic counts made throughout the year, compare with the results of cyclic count(s) observed and investigate significant differences in results.

2. Determine whether adjustments resulting from cyclic counts were adequately investigated, assessed as to implications regarding accuracy of the records and recorded.

IV Inventories held by third parties

1. Agree confirmed or observed quantities with client's detailed records.

2. Agree unit prices to appropriately tested source documents.

3. Test mathematical accuracy of extensions and footings.

4. Ascertain that total consigned material is included in the final inventory.

5. Include consigned inventory in analyses of excess, slow moving or obsolete inventory.