

Guidance Note on Audit of Inventories

The Guidance Note deals with procedures of the auditor in respect of audit of inventories. It outlines the peculiar features of inventories, which impact the audit procedures. The following is a gist of the important aspects of audit of inventories covered by the Guidance Note:

- *Internal Control Evaluation*: segregation of incompatible functions, standard form for recording movement of inventory, cross checking of data generated by different departments.
- *Verification*: management's responsibility for physical verification, sufficient appropriate audit evidence for existence, ownership and valuation, procedures for verification by auditor.
- *Examination of Records*: type of records, extent of auditor's examination, auditor's procedures in case of absence or insufficiency of records.
- *Attendance at Stock Taking*: need for auditor's attendance at stock taking, methods and procedures for stock taking, factors to be considered and procedures to be adopted in assessing the adequacy of stock taking, movement of stocks during stock taking, cut off procedures.
- *Confirmation from Third Parties*: factors to be seen, confirmations from third parties.
- *Examination of Valuation and Disclosures*: basis for valuation of inventories and methods of applying the basis, compliance with Accounting Standard (AS) 2, "Valuation of Inventories", use of standard costing, examination of the disclosure in financial statements.
- *Analytical Review Procedures*: illustrative analytical procedures, comprising mainly of comparison of various elements.
- *Work in Progress*: assessing appropriateness of its valuation etc.
- Management Representations
- Documentation by the auditor

The Guidance Note also gives illustrated set of instructions to be issued by the client to its staff responsible for stock taking, illustrative letter of confirmation of inventories held by others, illustrative letter of confirmation of inventories held by the entity on behalf of others and an illustrative management representation letter for inventories.

The Clarification issued by the Institute on the auditor's duties where inventories are stated to be "As Valued and Certified by the Management" in the financial statements, issued in September, 1999, has also been given.

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