

## AU Section 331

### *Inventories*<sup>\*</sup>

**Source: SAS No. 1, section 331; SAS No. 43; SAS No. 67.**

**Issue date, unless otherwise indicated: November, 1972.**

**.01** Observation of inventories is a generally accepted auditing procedure. The independent auditor who issues an opinion when he has not employed them must bear in mind that he has the burden of justifying the opinion expressed. [As amended, effective for fiscal periods ending after June 15, 1992, by Statement on Auditing Standards No. 67.]

**.02** The purpose of this section is to provide guidelines for the independent auditor in observing inventories. This section relates only to observation of inventories and does not deal with other important auditing procedures which generally are required for the independent auditor to satisfy himself as to these assets. [Revised, December 1991, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 67.]

### Receivables

[.03-.08] [Superseded November 1991 by Statement on Auditing Standards No. 67.]<sup>[1-2]</sup>

### Inventories

**.09** When inventory quantities are determined solely by means of a physical count, and all counts are made as of the balance-sheet date or as of a single date within a reasonable time before or after the balance-sheet date, it is ordinarily necessary for the independent auditor to be present at the time of count and, by suitable observation, tests, and inquiries, satisfy himself respecting the effectiveness of the methods of inventory-taking and the measure of reliance which may be placed upon the client's representations about the quantities and physical condition of the inventories.

**.10** When the well-kept perpetual inventory records are checked by the client periodically by comparisons with physical counts, the auditor's observation procedures usually can be performed either during or after the end of the period under audit.

**.11** In recent years, some companies have developed inventory controls or methods of determining inventories, including statistical sampling, which are highly effective in determining inventory quantities and which are sufficiently reliable to make unnecessary an annual physical count of each item of inventory. In such circumstances, the independent auditor must satisfy himself that

---

\* Title amended, effective for audits of fiscal periods ending after June 15, 1992, by Statement on Auditing Standards No. 67.

<sup>[1-2]</sup> [Superseded November 1991, by Statement on Auditing Standards No. 67.]

the client's procedures or methods are sufficiently reliable to produce results substantially the same as those which would be obtained by a count of all items each year. The auditor must be present to observe such counts as he deems necessary and must satisfy himself as to the effectiveness of the counting procedures used. If statistical sampling methods are used by the client in the taking of the physical inventory, the auditor must be satisfied that the sampling plan is reasonable and statistically valid, that it has been properly applied, and that the results are reasonable in the circumstances. [Revised, June 1981, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 39.]

**.12** When the independent auditor has not satisfied himself as to inventories in the possession of the client through the procedures described in paragraphs .09 through .11, tests of the accounting records alone will not be sufficient for him to become satisfied as to quantities; it will always be necessary for the auditor to make, or observe, some physical counts of the inventory and apply appropriate tests of intervening transactions. This should be coupled with inspection of the records of any client's counts and procedures relating to the physical inventory on which the balance-sheet inventory is based.

**.13** The independent auditor may be asked to audit financial statements covering the current period and one or more periods for which he had not observed or made some physical counts of prior inventories. He may, nevertheless, be able to become satisfied as to such prior inventories through appropriate procedures, such as tests of prior transactions, reviews of the records of prior counts, and the application of gross profit tests, provided that he has been able to become satisfied as to the current inventory.

### **Inventories Held in Public Warehouses<sup>3</sup>**

**.14** If inventories are in the hands of public warehouses or other outside custodians, the auditor ordinarily would obtain direct confirmation in writing from the custodian. If such inventories represent a significant proportion of current or total assets, to obtain reasonable assurance with respect to their existence, the auditor should apply one or more of the following procedures as he considers necessary in the circumstances.

- a. Test the owner's procedures for investigating the warehouseman and evaluating the warehouseman's performance.
- b. Obtain an independent accountant's report on the warehouseman's control procedures relevant to custody of goods and, if applicable, pledging of receipts, or apply alternative procedures at the warehouse to gain reasonable assurance that information received from the warehouseman is reliable.
- c. Observe physical counts of the goods, if practicable and reasonable.
- d. If warehouse receipts have been pledged as collateral, confirm with lenders pertinent details of the pledged receipts (on a test basis, if appropriate).

[As amended, effective after August 31, 1982, by Statement on Auditing Standards No. 43.]

---

<sup>3</sup> See section 901 for Special Report of Committee on Auditing Procedure.

## Effect on the Auditor's Report

**.15** For a discussion of the circumstances relating to receivables and inventories affecting the independent auditor's report, see sections 508.24 and 508.67. [As amended, effective for periods ending on or after December 31, 1974, by Statement on Auditing Standards No. 2. Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, effective after August 1982.]

---