

Targeted Standards in the ISA 500 Series – Issues Paper – Inventory

This Agenda Item sets out the project team's views and recommendations addressing all topics on audit evidence related to inventory in ISA 501¹ included in the [project proposal](#).

Matters Addressed in this Agenda Item

1. This paper sets out the following:
 - (a) **Part A:** Implications of the use of technology² by entities in managing inventory and by auditors in auditing inventory.*
 - (b) **Part B:** Attendance at inventory counting.*
 - (c) **Part C:** Alignment with concepts for the identification and assessment of, and responding to, risks of material misstatement.#
 - (d) **Part D:** Inventory under the custody and control of a third party.#
 - (e) **Part E:** Sufficiency and appropriateness of audit evidence obtained for inventory.*
 - (f) **Part F:** Professional skepticism – inventory.*

Topics marked with a hashtag (#) are topics that the Board discussed in its March 2026 meeting. For these topics, the project team is proposing preliminary drafting for requirements and application material.

Topics marked with an asterisk (*) have not yet been discussed with the Board. In addition to discussing the relevant issues, the project team is also presenting drafting for requirements only (unless otherwise stated).

Part A: Implications of the Use of Technology by Entities in Managing Inventory and by Auditors in Auditing Inventory

Background Information

Key Issue

2. ISA 501 does not sufficiently reflect the use of new and evolving technologies by entities in inventory management or by auditors in performing audit procedures for inventory. As a result, there is a risk that auditors may not adequately address emerging risks or practical challenges arising from the use of technology by both the entity and the auditor.³

Proposed Actions

3. The project proposal includes standard-setting actions to enhance application material to recognize the impact of management's use of technology in inventory management or by auditors in performing

¹ International Standard on Auditing (ISA) 501, *Audit Evidence—Specific Considerations for Selected Items* – Inventory

² References to the term “technology” include “emerging technologies.”

³ See [project proposal](#), paragraph 17(a).

audit procedures for inventory. This would also involve considering emphasizing in application material the auditor's responsibilities regarding:

- (a) The design, implementation and operating effectiveness of relevant controls in accordance with ISA 315 (Revised 2019)⁴ and Proposed ISA 330 (Revised),⁵ particularly where entities use sophisticated end-to-end systems and perform cycle counts.⁶
- (b) Determining the need for an expert in accordance with ISA 220 (Revised)⁷ and ISA 620,⁸ including when obtaining and evaluating audit evidence for complex and technology-enabled inventory systems.

Current Approach in the IAASB Standards

- 4. The use of technology by entities in managing inventory and by auditors in auditing inventory is not explicitly addressed in extant ISA 501.

Feedback from Stakeholder Outreach⁹

- 5. The table below summarizes the feedback from stakeholder outreach regarding this topic.

Appropriate Use of Technology

- Stakeholders recognized the importance of appropriately using technology to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory.
- Stakeholders are of the view that ISA 501 does not sufficiently address the use of technology and should therefore be updated to reflect the current business and audit environment more appropriately.

Not Mandate the Use of Technology

- Stakeholders noted that while ISA 501 should be revised to address responses to new or changing risks arising from technology, it should not mandate the use of technology. They:
 - Emphasized the importance of keeping the standard principles-based as inventory processes in small- and medium-sized entities have not significantly evolved and because this could stifle innovation or limit the adoption of future technologies.
 - Noted that the standard should remain scalable and suitable for varying levels of technological sophistication.

⁴ ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

⁵ See Proposed ISA 330 (Revised), *The Auditor's Responses to Assessed Risks*, presented in [Agenda Item 2-B](#) of the June 2026 IAASB meeting.

⁶ When an entity performs an inventory cycle count instead of a full physical count, it means they are choosing to count smaller subsets of inventory items on a rotating basis, rather than counting all inventory items at once.

⁷ ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

⁸ ISA 620, *Using the Work of an Auditor's Expert*

⁹ Refer to [Agenda Item 11-B](#) of the December 2025 IAASB meeting, [Agenda Item 8](#) of the March 2026 IAASB meeting and **Appendix 2 to Agenda Item 4** for a comprehensive overview of the feedback received from the project outreach undertaken to date with a broad range of stakeholders.

Design, Implementation and Operating Effectiveness of Relevant Controls

- Stakeholders suggested emphasizing the auditor's responsibilities regarding the design, implementation and operating effectiveness of relevant controls, including general information technology controls (GITCs).

Use of an Expert

- Stakeholders highlighted the need for an expert in certain circumstances when entities are using end-to-end and more complex inventory systems, including when using perpetual inventory systems with cycle counts.
- Stakeholders suggested explicitly permitting the use of a service provider to supplement resources used to attend inventory counts, given the limited resources of small and medium practices auditors to attend multiple counts occurring at the same time at different locations.

Use of a System and Organization Controls Report

- Stakeholders highlighted the value of using a system and organization controls report, when available, and emphasized the need for the auditor to consider relevant inventory controls at both the entity and the service organization.

Need for Non-Authoritative Material

- Stakeholders suggested developing non-authoritative material to:
 - Provide guidance on the use of technology. Guidance could cover how technology used by entities to manage inventory affects the risks of material misstatement related to the existence and condition of inventory and how this could influence the auditor's approach.
 - Enhance auditors' professional judgment in using technology.

Project Team's Views and Recommendations

6. The project team considered how to enhance application material in ISA 501 in the following areas:
 - (a) The impact of using technology on the entity's inventory management and on the audit.
 - (b) The auditor's responsibilities regarding the design, implementation and operating effectiveness of relevant controls.
 - (c) The auditor's responsibilities for determining the need for, and use of, an expert.

Impact of Entities' Use of Technology on the Audit

7. Since ISA 501 was written in December 2008, entities have increasingly used technology to record, track and monitor inventory. In addition, the use of technology (e.g., automated inventory management systems, Radio Frequency Identification tagging, drones, robotics, artificial intelligence and advanced data analytics tools) will continue to change the way entities record, track and monitor inventory. Technology has often fundamentally changed how the quantity and condition of inventory are determined, controlled and evidenced by management. Therefore, they have implications on the

nature, timing and extent of the auditor's audit procedures addressing the existence and condition of inventory. Similarly, auditors may use technological tools (e.g., data analytics, automated extraction tools or remote observation tools) when performing audit procedures relating to inventory.

8. The project team recommends enhancing application material to recognize how entities' use of technology in inventory management may impact the audit, including relating to:
- (a) Management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting. When management uses technology to perform or support physical inventory counts, the auditor may need to understand and evaluate the design and implementation of relevant controls over these technologies. This may also affect the procedures performed to evaluate whether management's instructions are properly designed and implemented.
 - (b) The accuracy and completeness of the entity's inventory records at the date of the financial statements. System-generated inventory reports produced by the entity's automated information systems are information from a source internal to the entity. The auditor is required by Proposed ISA 500 (Revised)¹⁰ to evaluate the relevance and reliability of information intended to be used as audit evidence, including obtaining audit evidence about the accuracy and completeness of such information, as necessary in the circumstances. This evaluation and the design and performance of audit procedures relating to the entity inventory records may include testing automated application controls and GITCs.
 - (c) The determination of inventory quantities in perpetual inventory systems. When the entity uses a sophisticated, end-to-end perpetual inventory system with continuous updating of inventory records, management may rely on cycle counts rather than a single period-end physical count. In such circumstances, the auditor may place greater emphasis on:
 - (i) Evaluating the design and implementation and testing the operating effectiveness of controls over the perpetual inventory system in accordance with ISA 315 (Revised 2019) and Proposed ISA 330 (Revised); and
 - (ii) Testing the reliability of cycle counts, including considerations that may inform the auditor's judgment about the adequacy of the cycle counts' frequency, coverage and how differences identified from cycle counts are resolved.

Auditor's Responsibilities Regarding Design, Implementation and Operating Effectiveness of Relevant Controls

9. The project team notes that ISA 315 (Revised 2019)¹¹ provides guidance about the use of technology in the entity's information system relevant to the preparation of the financial statements. While emerging technologies may be seen to be more sophisticated or more complex compared to traditional technologies, the auditor's responsibilities in relation to IT applications and identified GITCs in accordance with paragraph 26(b)–(d) of ISA 315 (Revised 2019) remain unchanged.
10. The project team also notes that, in applying ISA 315 (Revised 2019), the auditor may identify IT applications within inventory management processes that give rise to IT-related risks. For example,

¹⁰ See Proposed ISA 500 (Revised), *Audit Evidence*, presented in [Agenda Item 2-C](#) of the June 2026 IAASB meeting.

¹¹ ISA 315 (Revised 2019), Appendix 5, paragraph 5

inventory systems that automatically update quantities based on real-time inputs may be integral to maintaining the accuracy and completeness of inventory records. The identification of IT-related risks relating to such inventory systems may, in turn, influence the auditor's design and performance of further audit procedures in accordance with Proposed ISA 330 (Revised).

11. Accordingly, the project team recommends enhancing the application material to:
 - (a) Highlight that when entities use technology in inventory management, the auditor has responsibilities in relation to IT applications and identified GITCs in accordance with paragraph 26(b)–(d) of ISA 315 (Revised 2019).
 - (b) Emphasize that, in applying ISA 315 (Revised 2019) and Proposed ISA 330 (Revised), the auditor may identify IT applications and automated controls, including relevant GITCs, within inventory management processes. These controls may be critical to maintaining the accuracy and completeness of the entity's inventory records. Accordingly, the auditor may need to test the design and operating effectiveness of such controls, particularly when substantive procedures alone cannot provide sufficient appropriate audit evidence.

Auditor's Responsibilities for Determining the Need for an Expert

12. The project team recommends enhancing application material to emphasize that, when management uses technology in inventory management, the auditor may determine that it may be necessary to involve an expert (e.g., an IT expert) to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. An expert may assist the auditor in:
 - (a) Evaluating the design and operation of technology-enabled management's instructions, and procedures for recording and controlling the results of the entity's physical inventory counting.
 - (b) Interpreting results of inspecting the existence and condition of inventory generated by technological tools. The project team notes that the use of an expert in interpreting results (e.g., results indicating damage, obsolescence or deterioration) reinforces the auditor's exercise of professional skepticism as this would involve a critical assessment of audit evidence.
 - (c) Evaluating the accuracy and completeness of system-generated inventory reports.

Matters for IAASB Consideration:

1. The Board is asked for their views on the project team's proposals to develop application material in ISA 501 addressing the implications of the use of technology by entities in managing inventory and by auditors in auditing inventory, as set out in paragraphs 8, 11 and 12.

Part B: Attendance at Inventory Counting

Background Information

Key Issue

13. There is a lack of clarity about whether "attendance" at inventory counting (unless impracticable) can include the use of technological tools for remote observations, for example, visual footage from

drones, scanners and camera systems. As a result, auditors may be uncertain whether or how such practices meet the relevant requirements of ISA 501.¹²

14. With the growing availability of reliable, technology-enabled, and third-party audit evidence sources, questions arise as to whether the standard should place greater emphasis on the sufficiency and appropriateness of audit evidence—regardless of whether it is obtained through physical attendance or alternative means.¹³

Proposed Actions

15. The project proposal includes standard-setting actions to enhance requirements or application material to clarify the concept of “attendance” at inventory counting, including the use of technological tools for remote inventory observations. This would also involve clarifying circumstances when attendance at inventory counting is necessary to obtain sufficient appropriate audit evidence about the existence and condition of inventory.

Current Approach in the IAASB Standards

16. Paragraph 4(a) of ISA 501 requires attendance at physical inventory counting, unless impracticable. However, the extant standard is unclear whether the concept of “attendance” at inventory counting accommodates the use of technological tools for remote attendance at management’s inventory counting.
17. If attendance at physical inventory counting is impracticable, paragraph 7 of ISA 501 requires auditors to perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory.

Feedback from Stakeholder Outreach¹⁴

18. The table below summarizes the feedback from stakeholder outreach regarding this topic.

Implications of Highly Automated, Real-Time Inventory Systems on the Requirement to Attend Physical Inventory Counts

- Stakeholders highlighted that in the current business environment entities are using end-to-end, fully automated inventory systems that require limited to no human intervention, so auditors need to adapt their approach and understand internal controls.

Physical Attendance at Inventory Counting

- Stakeholders noted that the requirement in extant ISA 501 for auditors’ attendance at physical inventory counting, unless impracticable:

¹² See [project proposal](#), paragraph 17(b).

¹³ See [project proposal](#), paragraph 17(b).

¹⁴ Refer to [Agenda Item 11-B](#) of the December 2025 IAASB meeting, [Agenda Item 8](#) of the March 2026 IAASB meeting and **Appendix 2 to Agenda Item 4** for a comprehensive overview of the feedback received from the project outreach undertaken to date with a broad range of stakeholders.

- Provides persuasive audit evidence, particularly when responding to risks of material misstatement due to fraud.
- Is overly restrictive and outdated.
- Is unclear whether it is a test of control or a substantive procedure.
- Is unclear whether it can include the use of technological tools for remote observations.

Remote Attendance at Inventory Counting Using Technological Tools

- Stakeholders noted that ISA 501 should be revised to allow greater flexibility by explicitly permitting the use of technology for remote observations when appropriate in the circumstances. They:
 - Noted that in some circumstances, remote attendance may provide persuasive audit evidence.
 - Pointed out that there is growing use of remote observation tools, which was accelerated by the COVID-19 pandemic.
 - Questioned whether ISA 501 would also apply to the audit of digital inventory assets as those are not physically observable.¹⁵
 - Highlighted the need for the standard to recognize the benefits of using technology in auditing inventory (e.g., coverage, access, safety) but also its limitations (e.g., blind spots, less persuasive evidence regarding obsolescence or damage). In addition, there may be an increased risk of manipulation by management when using technological tools (e.g., deep fake risks).
 - Suggested clarifying that remote attendance may provide persuasive audit evidence in certain circumstances and therefore is not an alternative procedure where physical attendance is impracticable.
- Certain stakeholders noted that the use of technology for remote attendance should be complementary only and not a substitute for physical attendance during inventory counts.

Project Team's Views and Recommendations

Implications of How Management Verifies the Existence and Condition of Inventory

19. The project team recognizes that ISA 501 was developed in a business environment where the existence and condition of inventory were predominantly verified by management through a single periodic, physical count near, or at, period-end.
20. Stakeholder feedback indicates that the use of highly automated, end-to-end systems is increasing and that inventory may not be counted in a single point-in-time exercise. Instead, it is often

¹⁵ Digital assets (such as cryptocurrencies) fall under International Accounting Standard (IAS) 2, *Inventories*, only if they are held for sale in the ordinary course of business. This typically applies to broker-traders or entities acting as traders, who measure them at fair value less costs to sell. Otherwise, they are usually accounted for under IAS 38, *Intangible Assets*.

continuously recorded through perpetual inventory systems, updated in real time via scanning or sensors and verified through cycle counts.

21. Through additional stakeholder outreach, the project team is exploring whether current or future advancements in inventory systems give rise to circumstances where entities may *not* perform any form of physical inventory verification and, if so, how:
 - (a) Prevalent this is; and
 - (b) Management verifies the existence and condition of inventory in such circumstances.
22. The results of this outreach will inform the project team's determination of whether the standard should address this.

Addressing Circumstances Where Entities Perform Physical Inventory Verifications

23. Irrespective of how management verifies the existence and condition of inventory, the project team is of the view that in revising ISA 501, the possible approaches for addressing the existence and condition of inventory would need to:
 - (a) Align with the risk-based approach in ISA 315 (Revised 2019) and Proposed ISA 330 (Revised) that requires auditors to design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement at the assertion level.
 - (b) Take into account the guidance in Proposed ISA 500 (Revised) (paragraph A14E) that:
 - (i) Auditors may perform audit procedures manually or using technological tools, individually or in combination with each other, to obtain audit evidence.
 - (ii) In some circumstances, due to the form of the underlying information, the use of a technological tool may be more effective or may provide more persuasive audit evidence, or may be necessary because it may not be possible or practicable to perform an audit procedure manually.
24. The project team acknowledges that physical attendance at inventory counting is a highly persuasive source of audit evidence as it enables the auditor to directly observe management's procedures, perform test counts and assess the condition of inventory with a high degree of auditor control. At the same time, the project team recognizes that technological tools enable auditors in some circumstances to attend inventory counting remotely using real-time video and other tools.
25. The project team is of the view that remote attendance may provide sufficiently persuasive audit evidence but that its effectiveness depends on the facts and circumstances of the engagement. In particular, the reliability of information intended to be used as audit evidence obtained through remote attendance may be affected by factors such as the auditor's ability to direct the observation, the integrity of the technology used and the assessed risks of material misstatement.
26. The project team is of the view that in higher-risk situations, physical attendance may be necessary, whereas in lower-risk circumstances, remote attendance in combination with other further audit procedures may be sufficient.
27. Therefore, the project team is of the view that the current approach in paragraph 4(a) of ISA 501 may be unclear about what the auditor's attendance at the entity's inventory counting (unless impracticable) means and how to apply the requirement depending on how entities perform inventory

counts. Also, retaining the current approach may not reflect how audit evidence can be obtained in practice using technological tools in performing audit procedures. Accordingly, the project team considered the following approaches regarding how attendance at inventory counting could be addressed in revising ISA 501:

- (a) Remove the reference to “physical” in the requirement (Option A); or
- (b) Retain extant approach, but clarify in the application material that remote attendance at inventory counting by using technological tools is an alternative audit procedure that auditors may perform (Option B).

Option A: Remove the Reference to “Physical” in the Requirement

- 28. Under Option A, the project team proposes to remove the reference to “physical” from the requirements in paragraphs 4–7 of ISA 501, which would then result to revised requirements that refer more broadly to the auditor’s “attendance at the entity’s inventory counting.”
- 29. The project team is of the view that specifying “physical” attendance may be unnecessarily prescriptive and may not fully reflect how entities are performing inventory counts and how audit evidence can be obtained in practice, particularly where technological tools may enable the auditor to observe the performance of management’s count procedures, inspect inventory and perform test counts.
- 30. Removing the reference to “physical” is intended to:
 - (a) Recognize that management may apply different modes of inventory counts and allow auditors to adapt their audit approach accordingly (i.e., it could be physical or remote).
 - (b) Ensure that the standard remains flexible and capable of accommodating evolving business and audit practices.
 - (c) Allow auditors to determine, through the exercise of professional skepticism and professional judgment, how best to achieve the objective of obtaining sufficient appropriate audit evidence regarding the existence and condition of inventory.
- 31. The application material could explain that attendance at inventory counting may be undertaken either physically or remotely by using technological tools, depending on the auditor’s evaluation of whether such mode of attendance enables the auditor to obtain sufficient and appropriate audit evidence regarding the existence and condition of inventory in the circumstances.
- 32. The project team further notes that enhancements to application material could also highlight that auditors are expected to exercise professional skepticism and professional judgment in determining:
 - (a) Whether physical or remote attendance is responsive to the assessed risks of material misstatement; and
 - (b) Whether the information intended to be used as audit evidence is relevant and reliable.
- 33. The project team also acknowledges that allowing remote attendance at inventory counting may introduce challenges, particularly in relation to the reliability of audit evidence obtained through using technological tools. These challenges include:

- (a) The risk that remote attendance may provide less persuasive evidence than physical attendance in certain circumstances, for example:
 - (i) When the nature and characteristics of the inventory make it difficult to assess its existence or condition remotely (e.g., when its condition is susceptible to damage, obsolescence or deterioration).
 - (ii) When the results of prior audits (e.g., identified misstatements or control deficiencies) increase the need for physical over remote attendance at inventory counting.
 - (b) The potential for manipulation or limitation of the auditor's observations.
34. To address these challenges, the project team notes that application material could emphasize:
- (a) The need to consider the assessed risks of material misstatement when determining the appropriateness of remote attendance versus physical attendance, including the reasons for the auditor's assessment of risks and the level of assessment, for example, the higher the auditor's assessment of inherent risk, the more persuasive audit evidence is required; and
 - (b) That remote attendance does not automatically provide equally persuasive audit evidence as physical attendance and that additional audit procedures may be necessary in the circumstances.

Option B: Retain Extant Approach, But Clarify in the Application Material that Remote Attendance at Inventory Counting by Using Technological Tools Is an Alternative Audit Procedure that Auditors May Perform

35. Under Option B, the project team considers to retain the extant approach in paragraph 4(a) of ISA 501, but at the same time clarify in application material that "remote attendance at inventory counting by using technological tools" is an alternative audit procedure, if physical attendance is impracticable.
36. This approach is anchored on stakeholders' view that consider physical attendance at inventory counting as an audit procedure that:
- (a) Is applicable in virtually all cases to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory.
 - (b) Provides more persuasive audit evidence than remote attendance, particularly in higher-risk circumstances.
37. Enhancements to application material under Option B could include proposals discussed in paragraphs 33 and 34.

Proposed Way Forward

38. On balance, the project team recommends Option A as this option enhances the flexibility of the requirements in ISA 501 in an environment where technological tools enable auditors to attend inventory counting remotely. Option A also addresses instances where physical attendance is impracticable and where remote attendance could be performed instead.

Matters for IAASB Consideration:

2. The Board is asked for their views on the project team's views and recommendations regarding the possible approaches for addressing attendance at inventory counting in revising ISA 501 discussed in paragraphs 28–37 and the proposed way forward for Option A presented in paragraph 38.

Part C: Alignment with Concepts for the Identification and Assessment of, and Responding to, Risks of Material Misstatement

Previous IAASB Deliberations

39. In March 2026, the Board broadly supported:
 - (a) Replacing the materiality-based conditionality in ISA 501 with a risk-based conditionality, supported by enhanced application material with stronger linkages to ISA 315 (Revised 2019) and Proposed ISA 330 (Revised).
 - (b) Clarifying that the conditional requirements in ISA 501 apply in all instances where the inventory's existence or condition (related to its valuation assertion) are assessed as relevant assertions in accordance with ISA 315 (Revised 2019), paragraph 29.
40. The Board also provided directional input to:
 - (a) Improve linkages between the audit procedures in ISA 501 for inventory and the risk assessment and risk response requirements in ISA 315 (Revised 2019) and Proposed ISA 330 (Revised), including how best to incorporate guidance on test of controls.
 - (b) Provide examples illustrating how the nature, timing and extent of audit procedures on inventory vary, beyond just changes in sample size, depending on the assessed risks of material misstatement at the assertion level.
 - (c) Clarify the relationship between the inventory's condition and the valuation assertion, including that not all valuation-related risks are addressed through the inventory audit procedures in ISA 501 (e.g., market risks).

Project Team's Views and Recommendations

41. The project team recommends enhancing relevant requirements (see paragraphs 4 and 8 of **Agenda Item 4-B**) by:
 - (a) Replacing the materiality-based conditionality in paragraphs 4 and 8 with a risk-based conditionality. This aims to address concerns about the inconsistency of ISA 501 with the risk-based approach in the ISAs.
 - (b) Clarifying that the requirements in paragraphs 4 and 8 apply when the inventory's existence or condition (related to its valuation assertion) are assessed as relevant assertions in accordance with ISA 315 (Revised 2019). Doing so will ensure that the required audit procedures for inventory are directly linked to any assessed risk of material misstatement at the assertion

level, thereby aligning Proposed ISA 501 (Revised)¹⁶ with the risk-based approach in ISA 315 (Revised 2019) and Proposed ISA 330 (Revised).

42. The project team also recommends enhancing paragraph 4(b) of Proposed ISA 501 (Revised) by clarifying that the entity's inventory records refer to those "as at the date of the count" as it was deemed unclear what "final" was referring to (i.e., inventory records at year end, or as at the date of the count). See paragraph 4(b) of **Agenda Item 4-B** for the proposed drafting.
43. The project team also recommends developing application material (see paragraphs A0A–A0C of **Agenda Item 4-B**) that:
 - (a) Links the inventory-related procedures to the risk assessment in ISA 315 (Revised 2019) and the risk response in Proposed ISA 330 (Revised).
 - (b) Explains how the nature, timing and extent of the audit procedures to be performed by auditors may vary depending on the auditor's risk assessment.
 - (c) Clarifies the relationship between the inventory's condition and the valuation assertion.

Matters for IAASB Consideration:

3. The Board is asked for their views on the proposed revisions in paragraphs 4–8 and A0A–A0C of **Agenda Item 4-B** and as discussed in paragraphs 41–43 above.

Part D: Inventory Under the Custody and Control of a Third Party

Previous IAASB Deliberations

44. In March 2026, the Board broadly supported reinforcing the linkages in ISA 501 to foundational requirements in ISA 315 (Revised 2019), Proposed ISA 330 (Revised) and Proposed ISA 500 (Revised), including that auditors need to obtain more persuasive audit evidence the higher the assessment of inherent risk.
45. The Board also provided directional input to:
 - (a) Clarify that the determination whether sole reliance on third-party external confirmation procedures may be appropriate depends not just on the level of assessed risk of material misstatement, but also on other considerations, including the relevance and reliability of information intended to be used as audit evidence (e.g., from external confirmation procedures performed in accordance with paragraph 8(a) of ISA 501).
 - (b) Clarify the potential limitations of the sufficiency and appropriateness of audit evidence regarding the existence and condition of inventory held by third parties obtained from performing external confirmation procedures.
 - (c) Emphasize the importance of auditors' considerations of inventory-related controls at both the entity and the third party, and clarify whether inventories held by third parties fall within the scope of ISA 402.¹⁷

¹⁶ Proposed ISA 501 (Revised), *Audit Evidence—Specific Considerations for Selected Items* – Inventory

¹⁷ ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*

- (d) Reinforce linkages between performing external confirmation procedures for inventory under the custody and control of a third party (in paragraph 8(a) of ISA 501) with relevant requirements in Proposed ISA 330 (Revised) and Proposed ISA 505 (Revised).¹⁸

Project Team's Views and Recommendations

46. The project team recommends enhancing the requirement and application material in Proposed ISA 501 (Revised) by:

- (a) Reinforcing linkages to foundational requirements in ISA 315 (Revised 2019) and Proposed ISA 330 (Revised). This includes:
 - (i) Enhancing (see paragraph 8 of **Agenda Item 4-B**):
 - a. The lead-in to paragraph 8 by clarifying that “depending on the circumstances,” the auditor performs one or both procedures required under paragraphs 8(a) or 8(b) of Proposed ISA 501 (Revised). This wording serves as a hook for the enhancements to the application material (see paragraph 46(b) below).
 - b. Paragraph 8(b) of Proposed ISA 501 (Revised) by changing the phrase “other audit procedures appropriate in the circumstances” to “other further audit procedures appropriate in the circumstances.” This better aligns with the concept of “further audit procedures” in Proposed ISA 330 (Revised).¹⁹
 - (ii) Enhancing application material (see paragraphs A14A–A14C of **Agenda Item 4-B**) by:
 - a. Highlighting that the auditor’s risk assessment in accordance with ISA 315 (Revised 2019) may identify different risks for inventory held by a third party than those held by the entity.
 - b. Emphasizing the importance of inventory-related controls at both the entity and the third party and clarifying when such arrangements may fall within the scope of ISA 402.
- (b) Clarifying potential limitations on the sufficiency and appropriateness of audit evidence obtained from performing external confirmation procedures. This is intended to reinforce the exercise of professional skepticism. See paragraph A14D of **Agenda Item 4-B** for the proposed drafting.
- (c) Clarifying circumstances when the auditor ordinarily considers it appropriate to perform inspection or other further audit procedures when addressing inventory under the custody and control of a third party. See paragraph A14E of **Agenda Item 4-B** for the proposed drafting.
- (d) Reinforcing linkages to relevant requirements addressing external confirmation procedures in Proposed ISA 505 (Revised). This is intended to address concerns that auditors may apply the requirement in paragraph 8(a) of Proposed ISA 501 (Revised) in isolation. See paragraph A15 of **Agenda Item 4-B** for the proposed drafting.

¹⁸ Proposed ISA 505 (Revised), *External Confirmations*

¹⁹ See Proposed ISA 330 (Revised), paragraph A5, presented in [Agenda Item 2-B](#) of the June 2026 IAASB meeting.

Matters for IAASB Consideration:

4. The Board is asked for their views on the proposed revisions in paragraphs 8 and A14A–A15 of **Agenda Item 4-B** and as discussed in paragraph 46 above.

Part E: Sufficiency and Appropriateness of Audit Evidence Obtained for Inventory

Background Information

Key Issue

47. There are identified recurring issues in audit procedures related to inventory, for example, lack of appropriate audit procedures for testing inventory movements between interim count dates and period-end dates, not evaluating the accuracy and completeness of period-end inventory reports, inadequate audit procedures when the entity performs cycle counts or maintains inventory in multiple locations.²⁰

Proposed Actions

48. The project proposal includes standard-setting actions to enhance requirements or application material that apply when obtaining sufficient appropriate audit evidence about:
- (a) The accuracy and completeness of the entity's inventory records at the date of the financial statements, including alignment with Proposed ISA 500 (Revised).
 - (b) Changes in inventory between the count date and the date of the financial statements.
49. The above would also involve emphasizing in application material the auditor's responsibilities relating to the design, implementation and operating effectiveness of relevant controls in accordance with ISA 315 (Revised 2019) and Proposed ISA 330 (Revised). For example, when management performs cycle inventory counts throughout the period or maintains inventory in multiple locations and the accuracy and completeness of the entity's inventory records at the date of the financial statements depends on the operating effectiveness of controls.

Current Approach in the IAASB Standards

50. ISA 501, paragraph 4(b), requires auditors to perform audit procedures over the entity's "final inventory records" to determine whether they accurately reflect actual inventory count results.
51. Paragraphs 5 and 6 of ISA 501 include conditional requirements that apply, respectively:
- (a) If physical inventory counting is conducted at a date other than the date of the financial statements—for the auditor to perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded.
 - (b) If the auditor is unable to attend physical inventory counting due to unforeseen circumstances—for the auditor to make or observe some physical counts on an alternative date and perform audit procedures on intervening transactions.

²⁰ See [project proposal](#), paragraph 17(e).

*Feedback from Stakeholder Outreach*²¹

52. The table below summarizes the feedback from stakeholder outreach regarding this topic.

Lack of, or Insufficient Procedures Performed Over Inventory

- Stakeholders highlighted the lack of, or insufficient procedures performed over inventory when:
 - Management performs cycle counts for perpetual inventory systems. Such counts are becoming more common and add complexity and new considerations for auditors. Inspection reports often note findings around the reliability and sufficiency of the audit evidence obtained in cycle counts.
 - Management maintains inventories in multiple locations.
 - Management performs inventory counting procedures before or after year-end. Stakeholders noted inspection findings on insufficient roll-forward or roll-back procedures when inventory counting is performed before or after year-end.

Need for Additional Guidance

- Stakeholders suggested developing guidance addressing the following circumstances:
 - When inventory locations not included in the count are not individually material, but are material when considered in the aggregate.
 - When inventory counts occur on different days.
 - When reconciling cycle counts with year-end inventory balances.

Project Team's Views and Recommendations

53. The project team proposes to address the sufficiency and appropriateness of audit evidence obtained for inventory by enhancing application material relating to:
- (a) The accuracy and completeness of the entity's inventory records at the date of the financial statements;
 - (b) Changes in inventory between the count date and the date of the financial statements, focusing on considerations when management performs cycle counts; and
 - (c) Inventories in multiple locations.

Accuracy and Completeness of the Entity's Inventory Records

54. The project team notes that Proposed ISA 500 (Revised) requires auditors to evaluate the relevance and reliability of information intended to be used as audit evidence. When information intended to be used as audit evidence is from sources internal to the entity, Proposed ISA 500 (Revised) requires auditors to obtain audit evidence about the accuracy and completeness of this information, as

²¹ Refer to [Agenda Item 11-B](#) of the December 2025 IAASB meeting, [Agenda Item 8](#) of the March 2026 IAASB meeting and **Appendix 2 to Agenda Item 4** for a comprehensive overview of the feedback received from the project outreach undertaken to date with a broad range of stakeholders.

necessary in the circumstances, to meet the intended purpose of the audit procedure(s). This would apply to the entity's inventory records.

55. The project team believes that the enhancements in Proposed ISA 500 (Revised)²² sufficiently respond to the proposed actions and that no additional revisions are needed in Proposed ISA 501 (Revised) other than reinforcing linkages to relevant foundational requirements and related application material in Proposed ISA 500 (Revised).

Changes in Inventory Between the Count Date and the Date of the Financial Statements

When Management Performs a Complete Physical Inventory Count Near Period-End

56. The project team notes that when management performs a full physical inventory count close to the date of the financial statements, the period between the count date and the financial statement date is typically short. In such circumstances, the auditor may place greater reliance on procedures that roll forward (or roll backward) inventory quantities from the count date to period-end.
57. The project team believes that roll forward (or roll backward) are common audit procedures in these circumstances and that this is sufficiently covered in extant ISA 501.

When Management Uses a Perpetual Inventory System Supported by Cycle Counts

58. The project team notes that when management uses a perpetual inventory system supported by cycle counts over a defined period, the auditor's procedures may need to address multiple count dates rather than a single point in time.
59. The project team recommends enhancing application material to:
- (a) Clarify that the principles that apply are the same as when management performs a complete physical inventory count near period end (i.e., paragraphs 4 and 5 of Proposed ISA 501 (Revised) apply); and
 - (b) Include practical examples of audit procedures that auditors may perform to obtain audit evidence about whether changes in inventory between the cycle count date(s) and the date of the financial statements are properly recorded.

Inventories in Multiple Locations

60. The project team notes that when inventory is held across multiple locations, additional risks (including aggregation risk) and operational complexities arise, particularly in relation to movements between count date(s) and period-end.
61. The project team recommends enhancing application material to:
- (a) Highlight risks associated with inventories at multiple locations, such as:
 - (i) Inconsistent application of counting procedures or controls across locations.
 - (ii) Timing differences and cut-off errors arising from goods in transit between locations at period-end.

²² See Proposed ISA 500 (Revised), paragraph 9A, presented in [Agenda 2-C](#) of the June 2026 IAASB Board meeting.

- (iii) Limitations in system integration where multiple IT systems are used, affecting the reliability of consolidated inventory records.
- (b) Highlight that auditors may need to:
 - (i) Observe inventory counts at multiple locations to assess whether procedures are applied consistently.
 - (ii) Verify whether inventory in transit is recorded in the appropriate location and accounting period.
 - (iii) Test controls over system interfaces, including completeness and accuracy of data transfers between systems.

Matters for IAASB Consideration:

5. The Board is asked for their views on the project team's views and recommendations related to the sufficiency and appropriateness of audit evidence obtained for inventory discussed in paragraphs 55, 57, 59 and 61.

Part F: Professional Skepticism – Inventory

Background Information

Key Issue

62. Given the issues that have been highlighted in **Parts A to E**, including the impact of technology and other areas of modernization, there is a need to emphasize the exercise of professional skepticism when obtaining and evaluating audit evidence about inventory.²³

Proposed Actions

63. The project proposal includes standard-setting actions to enhance requirements or application material, to reinforce the exercise of professional skepticism when obtaining and evaluating audit evidence about inventory (e.g., with respect to the reliability of confirmation responses regarding inventory under the custody and control of a third party in ISA 501), including by taking into account how the concept of professional skepticism has been reinforced in recently revised ISAs.

Current Approach in the IAASB Standards

64. ISA 501 does not currently include any specific requirement or application material related to professional skepticism.

Feedback from Stakeholder Outreach²⁴

65. The table below summarizes the feedback from stakeholder outreach regarding this topic.

²³ See [project proposal](#), paragraph 17(f).

²⁴ Refer to [Agenda Item 11-B](#) of the December 2025 IAASB meeting, [Agenda Item 8](#) of the March 2026 IAASB meeting and **Appendix 2 to Agenda Item 4** for a comprehensive overview of the feedback received from the project outreach undertaken to date with a broad range of stakeholders.

Exercising Professional Skepticism When Obtaining and Evaluating Audit Evidence About Inventory

Stakeholders emphasized the need to enhance the auditor's procedures for inventory under the custody and control of a third party (e.g., emphasize the importance of understanding the entity's internal controls and exercising professional skepticism) in view of concerns about overreliance on third-party confirmations.

Project Team's Views and Recommendations

66. The project team recommends not adding a separate requirement addressing professional skepticism in Proposed ISA 501 (Revised) as the proposals to enhance the standard discussed in this paper sufficiently reinforce the appropriate exercise of professional skepticism. For example, the following proposals emphasize the importance of exercising professional skepticism when obtaining and evaluating audit evidence about:
- (a) The condition of inventory that is susceptible to damage, obsolescence or deterioration. As described in **Part A**, paragraph 12(b), the project team recommends reinforcing the exercise of professional skepticism by highlighting in application material that the use of an expert may assist the auditor in interpreting results of technology-enabled procedures.
 - (b) Inventory counts, either through physical or remote attendance. As described in **Part B**, paragraph 32, the project team recommends reinforcing the exercise of professional skepticism by highlighting in application material that auditors are expected to determine:
 - (i) Whether physical or remote attendance is responsive to the assessed risks of material misstatement; and
 - (ii) Whether the information intended to be used as audit evidence is relevant and reliable.
 - (c) Inventory under the custody and control of a third party. As described in **Part D**, paragraph 46(b), the project team recommends reinforcing the exercise of professional skepticism by clarifying in the application material the potential limitations on the sufficiency and appropriateness of audit evidence obtained from performing external confirmation procedures.
67. In addition, the project team notes that Proposed ISA 501 (Revised) deals with specific considerations by the auditor with respect to the existence and condition of inventory in obtaining sufficient appropriate audit evidence in accordance with Proposed ISA 330 (Revised) and Proposed ISA 500 (Revised). Both these standards provide baseline requirements relating to the auditor's exercise of professional skepticism and the proposals to revise ISA 501 include enhancing the linkages to Proposed ISA 330 (Revised) and Proposed ISA 500 (Revised).

Matters for IAASB Consideration:

6. The Board is asked for their views on the project team's views based on proposals in **Parts A, B and D** addressing professional skepticism in Proposed ISA 501 (Revised) discussed in paragraphs 66 and 67.