

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

This Agenda Item includes a draft of Proposed ISA 501 (Revised), as it relates to inventory. This Agenda Item is marked from the requirements and application material included in [Agenda Item 4-B](#) of the June 2026 IAASB meeting or from extant ISA 501 for the application material not already covered in Agenda Item 4-B.

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence in accordance with [Proposed](#) ISA 330 [\(Revised\)](#),¹ [Proposed](#) ISA 500 [\(Revised\)](#)² and other relevant ISAs, with respect to certain aspects of inventory, litigation and claims involving the entity, and segment information in an audit of financial statements.

Effective Date

2. This ISA is effective for audits of financial statements for:
 - (a) ~~periods~~ [Periods](#) beginning on or after December 15, ~~2009~~[20XX](#) [for the section relating to inventory; and](#)
 - (b) [Periods beginning on or after December 15, 2009 for the sections relating to litigation and claims and segment information.](#)

Objective

3. The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the:
 - (a) Existence and condition of inventory;
 - ...

Requirements

Inventory

- 3A. [If the auditor determines, in accordance with ISA 315 \(Revised 2019\),³ that existence and valuation \(in relation to condition\) are relevant assertions for inventory, the auditor's further audit procedures⁴ shall include the following depending on the circumstances: \(Ref: Para. A0A–A0G\)](#)
 - (a) [If the entity conducts a full inventory count, testing the entity's full inventory count in accordance with paragraphs 4–6;](#)
 - (b) [If the entity conducts cycle counts, testing the entity's cycle counts in accordance with](#)

¹ [Proposed](#) ISA 330 [\(Revised\)](#), *The Auditor's Responses to Assessed Risks*

² [Proposed](#) ISA 500 [\(Revised\)](#), *Audit Evidence*

³ [ISA 315 \(Revised 2019\), Identifying and Assessing the Risks of Material Misstatement, paragraph 29](#)

⁴ [Proposed](#) ISA 330 [\(Revised\)](#), [paragraphs 6–7](#)

paragraphs 4 and 6A; or

- (c) If the entity does not conduct a full inventory count or cycle counts, testing how the entity addresses the existence and condition of inventory in accordance with paragraph 6B.

Testing the Entity's Full Inventory Count or Cycle Counts

4. ~~If the auditor determines that inventory is a significant account balance in accordance with ISA 315 (Revised 2019)⁵ and that the assessed risks of material misstatement relate to the existence or condition of inventory,⁶ When testing the entity's full inventory count or cycle counts, the auditor's further audit procedures shall obtain sufficient appropriate audit evidence regarding the existence or condition of inventory by include:~~ (Ref: Para. ~~A0HA0A–A0G~~)
- (a) Attending the entity's inventory counting, unless impracticable, to: (Ref: Para. ~~A4A0I–A3A3C~~)
- (i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's inventory counting; (Ref: Para. A4-~~A4A~~)
 - (ii) Observe the performance of management's count procedures; (Ref: Para. A5)
 - (iii) Inspect the inventory; and (Ref: Para. A6)
 - (iv) Perform test counts; and (Ref: Para. A7–A8)
- (b) ~~Performing audit procedures over~~Determining whether the ~~entity's~~ inventory records ~~as~~ at the entity's count date ~~of the count to determine whether they~~ accurately reflect actual the results of the entity's inventory count ~~results~~. (Ref: Para. A8A)

Full Inventory Count

5. If the entity's full inventory counting is conducted at a date other than the date of the financial statements,⁷ the auditor shall, in addition to the procedures required by paragraph 4, perform further audit procedures to obtain audit evidence about whether changes in inventory between the entity's count date and the date of the financial statements are properly recorded. (Ref: Para. A9-~~A11A9A~~)
6. If the auditor is unable to attend the entity's full inventory counting due to unforeseen circumstances, the auditor shall perform the following further audit procedures ~~make or observe some counts~~ on an alternative date, ~~and perform audit procedures on intervening transactions~~. (Ref: Para. A9B)
- (a) Evaluate management's instructions and procedures for recording and controlling the results of the entity's inventory count;
 - (b) Inspect the inventory;
 - (c) Perform test counts; and
 - (d) Determine whether the entity's inventory records on the alternative date accurately reflect the results of the auditor's test counts.

⁵—ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*, paragraph 29

⁶—ISA 315 (Revised 2019), paragraph 28

⁷—Proposed ISA 330 (Revised), paragraphs 12 and 18

Cycle Counts

- 6A. When testing the entity's cycle counts, the auditor shall determine whether further audit procedures in addition to those in paragraph 4 are necessary to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory at the date of the financial statements. (Ref: Para. A10–A11A)

Testing How the Entity Addresses the Existence and Condition of Inventory Where the Entity Does Not Conduct a Full Inventory Count or Cycle Counts

- 6B. When testing how the entity addresses the existence and condition of inventory where the entity does not conduct a full inventory count or cycle counts, the auditor shall: (Ref: Para. A11B)
- (a) Obtain audit evidence about the operating effectiveness of the controls that address risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence regarding the existence and condition of inventory;⁸ and (Ref: Para. A11C)
 - (b) Determine whether and, if so, the nature, timing and extent of additional substantive procedures, tests of controls, or a combination of both, that are necessary in the circumstances to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory at the date of the financial statements.⁹ (Ref: Para. A11D)

Attendance at the Entity's Full Inventory Count or Cycle Counts Is Impracticable

7. If the auditor's attendance at the entity's full inventory counting or cycle counts in accordance with paragraph 4 is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory at the date of the financial statements. If it is not possible to do so, the auditor shall modify the opinion in the auditor's report in accordance with ISA 705 (Revised).¹⁰ (Ref: Para. A12–A14)

Inventory Under the Custody and Control of a Third Party

8. If the auditor determines, in accordance with ISA 315 (Revised 2019),¹¹ that inventory under the custody and control of a third party represents a significant account balance in accordance with ISA 315 (Revised 2019)¹² and that the assessed risks of material misstatement relate to the existence or and valuation (in relation to condition) are relevant assertions for ~~of~~ inventory under the custody and control of a third party, the auditor shall obtain sufficient appropriate audit evidence¹³ regarding the existence or condition of that inventory by performing, depending on the circumstances, one or both of the following: (Ref: Para. A14A–A14G, A14B and A15A)
- (a) Requesting confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity; or (Ref: Para. A14D and A15)

⁸ Proposed ISA 330 (Revised), paragraph 14

⁹ Proposed ISA 330 (Revised), paragraph 7(b)

¹⁰ ISA 705 (Revised), Modifications to the Opinion in the Independent Auditor's Report, paragraph 13

¹¹ ISA 315 (Revised 2019), paragraph 29

¹² ISA 315 (Revised 2019), paragraph 29

¹³ Proposed ISA 330 (Revised), paragraphs 6–7

- (b) Performing inspection of that inventory or determining other types of further audit procedures in performing substantive procedures, tests of controls, or a combination of both, appropriate in the circumstances.¹⁴ (Ref: Para. A14E–A14F)

Unable to Obtain Sufficient Appropriate Audit Evidence

8A. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory, the auditor shall modify the opinion in the auditor's report in accordance with ISA 705 (Revised).¹⁵ (Ref: Para. A14 and A14B)

Application and Other Explanatory Material

Inventory (Ref: Para. 43A)

Relationship Between the Valuation Assertion and the Condition of Inventory

~~A0CA0A~~. The audit procedures required to be performed in accordance with this ISA may not by themselves provide sufficient appropriate audit evidence regarding the valuation assertion for inventory. These procedures address the condition of inventory, which is related to its valuation, but may not provide all audit evidence regarding the valuation assertion, for example, relating to:

Examples:

Performing the audit procedures required by this ISA may not provide audit evidence regarding the valuation assertion of inventory on matters such as:

- The assessment of net realizable value, including expected selling prices and costs to complete; and
- ~~The Consideration~~ consideration of obsolescence other than the condition of inventory, market conditions, demand trends, and pricing volatility.

[Moved from paragraph A0C]

Further Audit Procedures Addressing the Existence and Condition of Inventory

A0B. The manner in which the entity verifies the existence and condition of inventory may vary.

Examples:

An entity may:

- Conduct a full inventory count at or near the date of the financial statements;
- Conduct cycle counts by counting a subset of inventory items on a rotating basis throughout the reporting period;
- Rely on controls, including general IT controls, relating to an automated inventory system;

¹⁴ Proposed ISA 330 (Revised), paragraph 7(b)

¹⁵ ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*, paragraph 13

or

- Apply a combination of the above approaches.

~~A0C~~A0A. ~~If the circumstances set out in paragraph 4 apply, t~~This ISA requires ~~the auditor to design and perform audit procedures to obtain sufficient appropriate audit evidence regarding the existence or and condition of inventory. The auditor's assessment of risks of material misstatement at the assertion level affects the auditor's design and performance of further audit procedures in the circumstances.~~¹⁶that the auditor's further audit procedures include those described in paragraph 3A, taking into account the auditor's understanding of how the entity addresses the existence and condition of inventory obtained in accordance with ISA 315 (Revised 2019),¹⁷ including:

- The nature of the entity's inventory and the type of inventory system used;
- The entity's use of technology in managing inventory; and
- The relevant IT applications, direct controls (e.g., manual or automated controls) and indirect controls, including general IT controls. [Moved from paragraph A0A]

~~A0D.~~ Matters relevant ~~in planning attendance at physical inventory counting (or in designing and performing further audit procedures pursuant to in accordance with paragraphs 4–8 of this ISA)~~ may include, for example:

- The assessed risks of material misstatement at the assertion level, including the reasons for the assessment of inherent risk and of control risk related to for the existence and condition of inventory in accordance with ISA 315 (Revised 2019).
- The nature of the entity's inventory (e.g., inventory susceptible to damage, deterioration and obsolescence).
- The nature, extent and complexity of technologies the entity uses in managing inventory.
- The nature design and implementation of the internal controls related relevant to the existence and condition of inventory.
- ~~Whether~~ The type of inventory system the entity maintains (e.g., a periodic or perpetual inventory system).
- ~~Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.~~
- ~~The timing of physical inventory counting.~~
- The locations at which inventory is held, including the materiality of the inventory, ~~and~~ the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate.
- Whether the involvement of members of the engagement team with specialized skills or knowledge, or the assistance of an auditor's expert is needed to assist the auditor in obtaining sufficient appropriate audit evidence regarding the existence and condition of inventory.

¹⁶ ~~Proposed ISA 330 (Revised), paragraph 6–7~~

¹⁷ ISA 315 (Revised 2019), paragraphs 19–26

Examples:

- Evaluating the inventory's condition where specialized skills are needed.
- Evaluating the accuracy and completeness of system-generated inventory records.

ISA 620¹⁸ deals with the use of an auditor's expert to assist the auditor to obtain sufficient appropriate audit evidence. **[Moved from paragraph A3]**

Inventory Held in Multiple Locations

A0E. In addition to aggregation risk,¹⁹ risks associated with inventory at multiple locations may relate to:

- Inconsistent application of counting procedures or other controls across locations.
- Timing differences and cut-off errors arising from goods in transit between locations at period-end.
- When multiple IT systems are used, system integration issues affecting the reliability of consolidated inventory records.

When Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence

A0F. In applying ISA 315 (Revised 2019),²⁰ in obtaining an understanding about the information processing activities and controls related to the entity's inventory management system and processes, the auditor may identify controls that address risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence. In such case, Proposed ISA 330 (Revised)²¹ requires the auditor to test the operating effectiveness of those controls.

Higher Assessment of Inherent Risk

~~A0GA0B~~.As the auditor's assessment of inherent risk increases on the spectrum of inherent risk, Proposed ISA 330 (Revised)²² requires the auditor to plan to obtain more persuasive audit evidence. This may affect the auditor's decisions regarding: ~~The nature of audit procedures (e.g., to design and perform other further audit procedures together with the procedures required by paragraph 4, or to design and perform additional further audit procedures); The timing of audit procedures (e.g., performing procedures at or near period end, rather than at an interim date); and The extent of observation and test counts at the entity's inventory counts, including full inventory counts or cycle counts (e.g., the number of inventory locations selected to visit, the number of inventory items subject to test~~

¹⁸ ISA 620, Using the Work of an Auditor's Expert

¹⁹ ISA 600 (Revised), Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors), paragraph 14(a)

²⁰ ISA 315 (Revised 2019), paragraphs 25–26

²¹ Proposed ISA 330 (Revised), paragraph 14

²² Proposed ISA 330 (Revised), paragraph 7(c)

count~~eds~~ and the introduction of an element of unpredictability, such as unannounced visits to inventory locations). **[Moved from paragraph A0B]**

Testing the Entity's Full Inventory Count or Cycle Counts (Ref: Para. 4)

A0H. The auditor may design and perform the further audit procedures described in paragraph 4 as tests of controls, substantive procedures, or a combination of both.²³ These audit procedures may ~~serve as test of controls or substantive procedures~~ be used for more than one purpose²⁴ depending on the auditor's ~~risk assessment~~, of identified risks of material misstatement at the assertion level in accordance with ISA 315 (Revised 2019)²⁵ and the auditor's planned approach ~~at the assertion level in accordance with Proposed ISA 330 (Revised) and the specific procedures carried out.~~²⁶

Attendance at the Entity's Physical Inventory Counting (Ref: Para. 4(a))

A0I. The auditor's attendance at the entity's full inventory count or cycle counts may be undertaken physically in person or, when appropriate in the circumstances, remotely through the use of technological tools.

A1. ~~Management ordinarily establishes procedures under which inventory is physically counted at least once a year to serve as a basis for the preparation of the financial statements and, if applicable, to ascertain the reliability of the entity's perpetual inventory system.~~

A2. ~~Attendance at physical inventory counting involves:~~

- ~~• Inspecting the inventory to ascertain its existence and evaluate its condition, and performing test counts;~~
- ~~• Observing compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count; and~~
- ~~• Obtaining audit evidence as to the reliability of management's count procedures.~~

~~These procedures may serve as test of controls or substantive procedures depending on the auditor's risk assessment, planned approach and the specific procedures carried out.~~

A3. **[Moved to paragraph A0D]**

Physical attendance

A3A. Physical attendance at the entity's inventory count may provide more persuasive audit evidence than remote attendance using technological tools in certain circumstances.

²³ [Proposed ISA 330 \(Revised\), paragraph 7\(b\)](#)

²⁴ [Proposed ISA 500 \(Revised\), paragraphs 10 and A26](#)

²⁵ [ISA 315 \(Revised 2019\), paragraph 13](#)

²⁶ [Proposed ISA 330 \(Revised\), paragraphs 6 and 7](#)

Examples:

- When the existence or condition of inventory cannot readily be assessed using technological tools because the inventory:
 - Is susceptible to deterioration, damage or obsolescence.
 - Has characteristics that cannot be adequately observed remotely.
- When the results of prior audits increase the need for physical over remote attendance at the entity's inventory count.
- When there is increased susceptibility to fraudulent financial reporting or misappropriation of assets, such as when inventory is high value, easily portable, or readily transferable.

Remote attendance

A3B. Appendix 3 of Proposed ISA 500 (Revised) highlights factors that may assist the auditor in identifying circumstances in which the use of technological tools may be appropriate when designing and performing audit procedures to meet their intended purpose(s).

Evaluate management's instructions and procedures (Ref: Para. 4(a)(i))

A4. Matters relevant in evaluating management's instructions and procedures for recording and controlling the physical results of the entity's inventory counting may include whether they address, for example:

- The application of appropriate controls, ~~for example, including collection of used physical inventory count records,~~ accounting for used and unused ~~physical~~ inventory count records, and count and re-count procedures.
- The assigned individuals who will perform management's count procedures, including whether those individuals possess the appropriate level of objectivity and competence.
- The accurate identification of the stage of completion of work in progress, of slow moving, obsolete or damaged items and of inventory owned by a third party, for example, on consignment.
- The procedures used to estimate ~~physical~~ quantities, where applicable, such as may be needed in estimating the ~~physical~~ quantity of a coal pile.
- Control over the movement of inventory between areas and the shipping and receipt of inventory before and after the cutoff date.
- The process for investigating and making adjustments for identified differences between the inventory records and the results of the entity's inventory count.

A4A. When testing the entity's cycle counts, in addition to the matters in paragraph A4, matters relevant in evaluating management's instructions and procedures for recording and controlling the results of the entity's inventory count may include whether they also address:

- The frequency and coverage of the entity's cycle count program.
- The basis for selecting inventory items or inventory locations to be counted.

- The activities to monitor the cycle count coverage by inventory item or inventory location and the overall results that enable management to conclude that the entity's perpetual inventory system is sufficiently reliable.

Observe the performance of management's count procedures (Ref: Para. 4(a)(ii))

- A5. Observing the performance of management's count procedures, for example, those relating to control over the movement of inventory before, during and after the count, assists the auditor in obtaining audit evidence that management's instructions and count procedures are adequately designed and implemented. In addition, the auditor may obtain copies of cutoff information, such as details of the movement of inventory, to assist the auditor in performing audit procedures over the accounting for such movements at a later date between the entity's count date and the date of the financial statements.

Inspect the inventory (Ref: Para. 4(a)(iii))

- A6. Inspecting inventory when attending the entity's physical inventory counting assists the auditor in ascertaining the existence of the inventory (though not necessarily its ownership), and in evaluating its condition by identifying, for example, obsolete, damaged or aging inventory.

Perform test counts (Ref: Para. 4(a)(iv))

- A7. Performing test counts, for example, by tracing items selected from management's count records to the physical-actual inventory and tracing items selected from the physical-actual inventory to management's count records, provides audit evidence about the accuracy completeness and the completeness accuracy of those records.
- A8. In addition to recording the auditor's test counts, obtaining copies of management's completed physical inventory count records assists the auditor in performing subsequent audit procedures to determine whether the entity's final inventory records accurately reflect actual inventory count results.

Determining Whether the Inventory Records Reflect the Results of the Entity's Inventory Count (Ref: Para. 4(b))

- A8A. In determining whether the inventory records at the date of the count accurately reflect the results of the entity's inventory count, the auditor may use information produced by the entity as audit evidence. Such information may include perpetual inventory records, inventory lists, inventory transfer reports or inventory reconciliation reports. If information intended to be used as audit evidence is information produced by the entity, Proposed ISA 500 (Revised)²⁷ requires the auditor to evaluate, to the extent necessary, the accuracy and completeness of the information to meet the intended purpose(s) of the audit procedures.

Full Inventory Count

Physical-If the Entity's Full Inventory Counting Is Conducted Other than at the Date of the Financial Statements (Ref: Para. 5)

- A9. For practical reasons, the physical-entity's full inventory counting may be conducted at a date, or dates, other than the date of the financial statements. This may be done irrespective of whether management

²⁷ Proposed ISA 500 (Revised), paragraph 12

determines inventory quantities by an annual physical inventory counting or by using technological tools in conducting the full inventory count, or whether the entity maintains a perpetual inventory system. In ~~either all cases, the effectiveness of~~ the design, implementation and ~~maintenance operating effectiveness~~ of controls over changes in inventory determines whether the conduct of ~~physical the entity's full~~ inventory counting at a date, or dates, other than the date of the financial statements is appropriate for audit purposes. Proposed ISA 330 (Revised) establishes requirements and provides guidance on the timing of substantive procedures and tests of controls, including those performed at an interim date.²⁸

A9A. The following are examples of audit procedures that auditors may perform if the entity's full inventory count is conducted at a date other than the date of the financial statements to address whether the changes in inventory between the entity's count date and the date of the financial statements are properly recorded.

Examples:

- Tests of details over:
 - Management's reconciliation of inventory records between the count date and the date of the financial statements.
 - Inventory movements between the count date and the date of the financial statements by tracing such movements from the inventory records to source documents.
- Tests of controls over inventory movements, including those relevant to the intervening period.

If the Auditor Is Unable to Attend the Entity's Full Inventory Count Due to Unforeseen Circumstances
(Ref: Para. 6)

A9B. If the auditor is unable to attend the entity's full inventory count due to unforeseen circumstances, the auditor is required to perform further audit procedures on an alternative date in accordance with paragraph 6 and may consider the matters described in paragraphs A4 and A6–A9A.

Examples:

Unforeseen circumstances may include:

- Severe weather events.
- Transportation disruptions.
- Sudden illness of the auditor.

Cycle Counts (Ref: Para. 6A)

A10. Where the entity has a perpetual inventory system ~~is maintained~~, management may perform physical cycle counts instead of, or in addition to, full inventory counts or other ~~tests-control activities~~ to ascertain the reliability of ~~inventory quantity information included in the~~ entity's perpetual inventory ~~recordssystem~~. ~~In some cases, management or the auditor may identify differences between the~~

²⁸ Proposed ISA 330 (Revised), paragraphs ~~2212–2313~~ and 18

~~perpetual inventory records and actual physical inventory quantities on hand; this may indicate that the controls over changes in inventory are not operating effectively.~~

A11. ~~When testing the entity's cycle counts, Relevant-relevant matters for consideration when in determining whether designing further audit procedures are necessary in addition to those required by paragraph 4 to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded may include:~~

- ~~• Whether the perpetual inventory records are properly adjusted.~~
- The assessed risks of material misstatement at the assertion level, including the reasons for the assessment of inherent risk and of control risk for the existence and condition of inventory in accordance with ISA 315 (Revised 2019).
- The Reliability-reliability of the entity's perpetual inventory records system, including: the results of the cycle counts and the Reasons-reasons for significant differences between the entity's perpetual inventory records and the results of information obtained during the physical entity's cycle counts and the perpetual inventory records. These differences may indicate that the entity's cycle count program is not designed, implemented or operating effectively.
- The period between the date the auditor tested the cycle count and date of the financial statements.²⁹

A11A. If there are differences between the entity's perpetual inventory records and the results of the entity's cycle counts, the auditor may:

- Obtain more persuasive audit evidence through substantive procedures by performing test counts of inventory quantities and by inspecting the condition of inventory near or at the date of the financial statements.
- Where mitigating or compensating controls exist that address the existence and condition of inventory, obtain audit evidence about the operating effectiveness of those controls.
- Request management to conduct a full inventory count near or at the date of the financial statements.

Testing How the Entity Addresses the Existence and Condition of Inventory Where the Entity Does Not Conduct a Full Inventory Count or Cycle Counts (Ref: Para. 6B)

A11B. In some entities, management may not perform a full inventory count at or near the date of the financial statements nor cycle counts throughout the reporting period. Instead, the entity may rely on controls related to an automated perpetual inventory system. These may include:

- Direct controls over the receipt, shipment or transfer of inventory;
- Indirect controls that support the operation of direct controls, including general IT controls; and
- Controls over the reconciliation between the entity's automated inventory system and the general ledger.

A11C. In such circumstances, the auditor may have determined, that it is impossible or impracticable to design effective substantive procedures that by themselves provide sufficient appropriate audit

²⁹ Proposed ISA 330 (Revised), paragraph 21

evidence regarding the existence and condition of inventory. This may be the case where the nature and scale of automation of an inventory system indicates that its reliability depends on controls that operate continuously as the inventory moves through the inventory system. If so, paragraph 6B(a) of this ISA requires the auditor to perform tests of controls that address risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence³⁰ regarding the existence and condition of inventory. Proposed ISA 330 (Revised)³¹ provides guidance on matters that the auditor may have considered in determining whether substantive procedures alone do not provide sufficient appropriate audit evidence.

A11D. The auditor may determine, in applying paragraph 6B(b), that additional substantive procedures, tests of controls, or a combination of both, are necessary in the circumstances to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. This may include performing:

- Tests of controls in addition to the controls already tested in accordance with paragraph 6B(a). This may be the case, for example, where the auditor determines that additional evidence about the operating effectiveness of controls is necessary to support the auditor's assessment of control risk.
- Additional substantive procedures. This may be the case when the results of tests of controls do not provide an appropriate basis for confirming the auditor's assessment of control risk,³² or performing tests of controls alone to respond to risks of material misstatements relating to the existence or condition of inventory is not appropriate in the circumstances.³³ This may include:
 - Performing test counts of inventory quantities and inspecting the condition of inventory near or at the date of the financial statements.
 - Testing adjustments to inventory records and investigating significant or unusual adjustments.

Attendance at ~~Physical~~the Entity's Full Inventory Counting or Cyle Counts Is Impracticable (Ref: Para. 7)

A12. In some cases, attendance (whether physical or remote) at ~~physical~~the entity's inventory counting may be impracticable (see paragraph A1). Impracticable circumstances arise when, despite reasonable efforts by the auditor to attend the entity's inventory count, attendance cannot reasonably be accomplished.~~This may be~~ due to factors such as the nature and location of the inventory, ~~for example,~~.

³⁰ Proposed ISA 330 (Revised), paragraph 14

³¹ Proposed ISA 330 (Revised), paragraph A48

³² Proposed ISA 330 (Revised), paragraph 26

³³ Proposed ISA 330 (Revised), paragraph 16

Examples:

- ~~where~~ Where inventory is held in a location that may pose threats to the safety of the auditor (e.g., inventory locations affected by war, civil unrest or outbreaks of disease).
- When the nature of the inventory is subject to stringent safety, security or regulatory restrictions (e.g., inventory that are radioactive or inventory held by pharmaceutical manufacturers).

A12A. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in ISA 200,³⁴ the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative, or to be satisfied with audit evidence that is less than persuasive.

A13. In some cases where attendance at the entity's inventory count is impracticable, alternative audit procedures, for example, inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the ~~physical entity's~~ inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory. This may be the case when the assessed risk of material misstatement at the assertion level is such that the inherent risk is not assessed on the higher end of the spectrum of inherent risk and no such risks are determined to be significant risks.

A14. In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. This may be the case, for example, when the audit evidence obtained by performing alternative procedures is not sufficiently persuasive compared to the audit evidence obtained by attending the entity's inventory count. In such cases, ISA 705 (Revised) requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.³⁵

Inventory ~~under~~ Under the Custody and Control of a Third Party (Ref: Para. 8)

A14A. The risks of material misstatement relating to inventory held by a third party may differ from those related to inventory held by the entity, including being affected by the inventory arrangements between the entity and the third party. These may include risks relating to:

- The safeguarding and physical condition of inventory.
- The accuracy and completeness of records maintained by the third party.
- ~~The~~ The potential for unauthorized use, transfer or disposal of inventory.
- The commingling of the entity's inventory with that of other entities being held by the same third party.

~~A14B. The auditor's consideration of the design and implementation of controls at the entity and at the third party that are relevant to the existence and condition of inventory may influence the nature, timing and extent of audit procedures performed under paragraph 8. For example, where controls at the entity or at the third party are relevant and are expected to be operating effectively, the auditor may~~

³⁴ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph A53

³⁵ ISA 705 (Revised), paragraph 13

~~determine that obtaining audit evidence about the operating effectiveness of those controls address the auditor's evaluation of the reliability of information from the third party intended to be used as audit evidence.³⁶ Conversely, where such controls are not suitably designed or implemented, the auditor may need to~~ In addition to the matters described in paragraph A0D, other matters that are relevant in designing and performing further audit procedures for inventory under the custody and control of a third party may include:

- ~~The design and implementation of controls at the entity and at the third party.~~
- ~~Whether or not the inventory arrangements between the entity and the third party limits the auditor's ability to perform certain audit procedures. For example, the auditor may be unable to inspect the inventory when access to the third-party custodian's premises is restricted. Where such limitations prevent the auditor from obtaining sufficient appropriate audit evidence regarding the existence and condition of inventory held by the third party, ISA 705 (Revised) requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.³⁷~~
- ~~Perform other audit procedures to evaluate the reliability of such information; or~~
- ~~Design and perform substantive procedures to respond to the assessed risks of material misstatement at the assertion level.~~

A14C. [Moved to paragraph A15A]

Confirmation or Other Audit Procedures (Ref: Para. 8(a) and 8(b))

A14D. Depending on the circumstances, external confirmation procedures may not, on their own, provide sufficient appropriate audit evidence regarding the existence ~~or~~ and condition of inventory held by a third party.

Examples:

External confirmation from a third-party custodian may not, on their own, provide sufficient appropriate audit evidence regarding:

- Existence – When inventory is commingled with that of other entities, ~~—~~ as it may be difficult for the confirming party to distinguish the entity's inventory.
- Condition – When inventory is susceptible to damage, obsolescence or deterioration, ~~an external confirmation from a third-party custodian may not provide sufficient information about the condition of the inventory.~~

~~A15A~~A14E. If the auditor decides to use external confirmation procedures in accordance with Proposed ISA 330 (Revised),³⁸ ~~the auditor is required to comply with~~ Proposed ISA 505 (Revised),³⁹ ~~which establishes requirements and provides guidance for performing external confirmation procedures.~~
[Moved from paragraph A15]

³⁶ ~~Proposed ISA 500 (Revised), paragraph 10B~~

³⁷ ISA 705 (Revised), paragraph 13

³⁸ Proposed ISA 330 (Revised), paragraph 11

³⁹ Proposed ISA 505 (Revised), *External Confirmations*

~~A14E~~A14F. The auditor ordinarily considers it appropriate to perform inspection of inventory held by a third party or determine other types further audit of procedures in performing substantive procedures, tests of controls, or a combination of both, instead of, or in addition to, sending an external confirmation request to the third-party custodian if:

- The assessed risks of material misstatement at the assertion level ~~is~~are such that the assessment of inherent risk is not ~~at-on~~ the lower end of the spectrum of inherent risk.
- Information is obtained that raises doubt about the integrity, competence, capability or objectivity of the third party or the auditor determines that a response to the external confirmation request is not or is not expected to be reliable.

A14F. Examples:

~~of~~Other further audit procedures may include:

- Attending, or arranging for another auditor to attend, the third party's ~~physical counting of~~ inventory count, if practicable.
- Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.
- Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts issued by a warehouse operator acknowledging that specified inventory has been received and is being held on behalf of the entity.
- Requesting confirmation from other parties when inventory has been pledged as collateral.
- Inspecting documentation regarding the inventory custody agreement between the entity and the third party to determine who is responsible for shortfalls of inventory.
- Inspecting the third party's inventory count documentation.

A15. [Moved to paragraph A14E]

When Third-Party Inventory Arrangements Are Within the Scope of ISA 402⁴⁰

A15A. Arrangements involving inventory held by a third party may fall within the scope of ISA 402⁴⁴ when the third party's services form part of the entity's information system relevant to the preparation of its financial statements. This may be the case, for example, when the third party:

- Maintains records of inventory quantities or condition on behalf of the entity.
- Processes transactions affecting inventory ~~balances~~records, such as receipts, issues, or transfers.

[Moved from paragraph A14C]

⁴⁰ ISA 402, Audit Considerations Relating to an Entity Using a Service Organization

⁴⁴ ISA 402, Audit Considerations Relating to an Entity Using a Service Organization