

ISA 500 Series – Cover Note

Objective

The objective is to obtain the Board's input on the restructuring and selected requirements of Proposed ISA 501 (Revised),¹ as it relates to inventory.

Introduction

Background

- At the September 2026 IAASB meeting, the Board discussed the proposed changes to ISA 501,² as it relates to inventory, including changes made to restructure ISA 501 based on comments made by the Board to rethink the structure of the standard to accommodate how inventory counts are performed in practice.

Materials Presented

- This paper includes one section describing the key matters considered since the September 2026 IAASB meeting regarding the restructuring of Proposed ISA 501 (Revised).
- This agenda item includes the following appendix and accompanying agenda item:

Appendix	Extracts of the Draft September 2026 IAASB Minutes of Meeting – ISA 500 Series Project as It Relates to the Restructuring of Proposed ISA 501 (Revised)
Agenda Item 2–A	Extracts of Proposed ISA 501 (Revised) – Inventory

Key Matters Considered Since the September 2026 IAASB Meeting Regarding the Restructuring of Proposed ISA 501 (Revised)

- Agenda Item 2–A** shows changes to selected requirements of Proposed ISA 501 (Revised), as it relates to inventory, in mark-up from [Agenda Item 7–E](#) discussed by the Board at the September 2026 meeting, as a result of comments received. The section below explains the key matters considered by the ISA 500 Series Project Team (the Project Team) since the September 2026 IAASB meeting regarding the restructuring of Proposed ISA 501 (Revised).

Previous IAASB Deliberations

- In September 2026, the Board supported retaining Proposed ISA 501 (Revised) as a separate standard and the overall direction for restructuring the standard as it relates to inventory and provided directional feedback to:

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

² ISA 501, *Audit Evidence—Specific Considerations for Selected Items*

- (a) Establish a stronger linkage to ISA 315 (Revised 2019)³ and Proposed ISA 330 (Revised).⁴
- (b) Clarify that the entity's approach to establishing the existence and valuation (in relation to the condition) of inventory at the date of the financial statements should not, by itself, determine the auditor's response to obtain sufficient appropriate audit evidence.
- (c) Further enhance requirements addressing circumstances in which the entity does not conduct a year-end inventory count or inventory cycle counts.

See the **Appendix** for the draft minutes.

Project Team's Views and Recommendations

Establishing a Stronger Linkage to ISA 315 (Revised 2019) and Proposed ISA 330 (Revised)

6. The Project Team agreed with the Board that the specific considerations by the auditor in obtaining sufficient appropriate audit evidence with respect to certain aspects of inventory in Proposed ISA 501 (Revised) should operate coherently with ISA 315 (Revised 2019) and Proposed ISA 330 (Revised). Accordingly, the Project Team:
- (a) Added a new requirement in paragraph 3A related to obtaining an understanding in accordance with ISA 315 (Revised 2019); and
 - (b) Enhanced the requirement in paragraph 3B by including linkages with the auditor's risk assessment in ISA 315 (Revised 2019) and the responses to assessed risks in Proposed ISA 330 (Revised).

Paragraph 3A

7. The Project Team is of the view that requiring the auditor to obtain an understanding of specific inventory-related matters would enhance the linkage between Proposed ISA 501 (Revised) and ISA 315 (Revised 2019). In addition, the Project Team is of the view that such understanding is needed in deciding which of the auditor's approaches in paragraph 3B to select in designing and performing further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level, as required by Proposed ISA 330 (Revised).⁵
8. The structure of paragraph 3A is based on the constructs of paragraph 32 of ISA 240 (Revised)⁶ and paragraph 13 of ISA 540 (Revised).⁷ The requirement in Proposed ISA 501 (Revised) focuses the auditor's risk assessment procedures on obtaining an understanding of the following inventory-related matters:
- (a) The nature of the inventory and where the inventory is located;
 - (b) The flow of information about inventory through the entity's information system and the entity's

³ ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

⁴ Proposed ISA 330 (Revised), *The Auditor's Responses to Assessed Risks*

⁵ Proposed ISA 330 (Revised), paragraphs 6–7

⁶ ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

⁷ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*, paragraph 13(d), (h) and (i)

process for establishing the existence and condition of inventory at the date of the financial statements; and

- (c) The identified controls in the control activities component that address risks of material misstatement relating to the existence and valuation (in relation to the condition) of inventory.
9. In circumstances in which the entity does not conduct any inventory count(s), the Project Team is of the view that discussing with management the reasons for not conducting any inventory counts is important to enable the auditor to understand how the entity establishes the existence and condition of inventory at the date of the financial statements (see paragraph 3A(b)). The reasons may reflect the nature and characteristics of the inventory, its reliance on a highly automated inventory system and related controls, or other circumstances affecting its ability to conduct an inventory count. This discussion also provides a basis for the auditor in determining, in accordance with paragraph 7A, whether an inventory count by the entity is necessary in the circumstances.

Application Material

10. The Project Team proposes to repurpose and reorganize application material presented to the Board at the September 2026 meeting or develop application material to:
- (a) Explain that paragraph 3A is part of applying the required understanding in ISA 315 (Revised 2019).
 - (b) Explain why understanding matters relevant to the existence and condition of inventory is necessary for a robust risk assessment.
 - (c) Provide guidance on matters that may be relevant when obtaining the required understanding in accordance with paragraph 3A.

Clarifying that the Entity's Approach Should Not, by Itself, Determine the Auditor's Response to Obtain Sufficient Appropriate Audit Evidence

11. To address the Board's concern that paragraph 3B should not be anchored solely on the entity's process for establishing the existence and condition of inventory, the Project Team deleted the anchor to the entity's process.
12. In addition, the Project Team replaced the word "testing" in paragraphs 3B(a) to (c) with the phrase "performing procedures" to better reflect what is included in the related requirements in paragraphs 4–7A.

Application Material

13. The Project Team proposes to repurpose and reorganize application material presented to the Board at the September 2026 meeting, or develop application material to:
- (a) Highlight that the auditor's approach selected under paragraphs 3B(a) to (c) primarily takes into account:
 - (i) The auditor's understanding of the inventory-related matters and the discussion with management described in paragraph 3A; and
 - (ii) 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 valuation (in

relation to the condition) of inventory.

- (b) Clarify that, depending on the circumstances, one or a combination of approaches in paragraphs 3B(a) to (c) may be appropriate.
- (c) Clarify that when the risk assessment procedures performed in accordance with ISA 315 (Revised 2019) indicate that the identified controls under paragraph 3A(a)(iii) are evaluated to be not designed effectively or determined to be not implemented, the further audit procedures contemplated under paragraphs 3B(a) to (c) may only be designed and performed as substantive procedures.

Enhancing Requirements Addressing Circumstances in Which the Entity Does Not Conduct Any Inventory Count(s) – Paragraph 7A

- 14. Paragraph 7A is intended to address circumstances in which the entity does not conduct any inventory counts. The Project Team is of the view that in such circumstances, the entity would ordinarily rely on controls related to its inventory system to satisfy itself about the existence and condition of inventory at the date of the financial statements. This may arise, for example, if the entity relies on a highly automated inventory system and processes or if the nature of the inventory is nonphysical (e.g., digital inventory).

The Construct of Paragraph 7A

- 15. In developing paragraph 7A, the Project Team leveraged constructs used in ISA 570 (Revised 2024).⁸ The Project Team considers it important that the absence of an inventory count by the entity should not, in itself, be accepted by the auditor without sufficient consideration of whether an inventory count by the entity is necessary in the circumstances. Therefore, the Project Team is of the view that when the entity does not conduct any inventory counts, the auditor should be required to determine whether an inventory count by the entity is necessary in the circumstances
- 16. The Project Team is of the view that an inventory count by the entity would ordinarily be necessary depending on the auditor's conclusion about:
 - (a) Whether the entity maintains a perpetual inventory system that provides a sufficient basis for establishing the existence and condition of inventory at the date of the financial statements;
 - (b) Whether the auditor, in accordance with ISA 315 (Revised 2019),⁹ has evaluated and determined that the identified controls are designed effectively and implemented (see requirement in paragraph 3A(a)(iii)); or
 - (c) Whether the inherent risk is not assessed on the higher end of the spectrum of inherent risk and no risks of material misstatement are determined to be significant risks.

Specificity of Requirements

- 17. The Project Team is of the view that the requirements in paragraphs 7A(a) and (b) establish the key judgments and actions expected of the auditor to obtain sufficient appropriate audit evidence in

⁸ ISA 570 (Revised 2024), *Going Concern*, paragraphs 20–23

⁹ ISA 315 (Revised 2019), paragraph 26

circumstances in which the entity does not conduct any inventory counts:

- (a) Paragraph 7A(a) – If the auditor determines that an inventory count by the entity is not necessary (also see paragraph 16), the auditor’s response is directed towards obtaining audit evidence about the operating effectiveness of identified controls and evaluating the results of such tests of controls in accordance with Proposed ISA 330 (Revised).¹⁰ However, the Project Team considers it important to address the possibility that testing the identified controls may not provide sufficient appropriate audit evidence. If this occurs, the Project Team is of the view that pointing auditors to relevant requirements in Proposed ISA 330 (Revised)¹¹ addressing the results of tests of controls is critically important.
 - (b) Paragraph 7A(b) – If the auditor determines that an inventory count by the entity is necessary (also see paragraph 16), paragraph 7A(b)(i) requires the auditor to request management to conduct an inventory count at or near the date of the financial statements. However, the Project Team recognizes that the auditor cannot compel management to conduct an inventory count. Accordingly, if management is unwilling to conduct an inventory count that the auditor determines necessary in the circumstances, the auditor is required to apply the requirement in paragraph 8A. Such an approach recognizes that, in these circumstances, alternative audit procedures would not be expected to provide sufficient appropriate audit evidence. Consequently, the auditor would be required to modify the opinion in the auditor’s report in accordance with ISA 705 (Revised).¹²
18. The Project Team believes this approach enables the auditor to apply professional judgment while providing auditors with sufficient guidance to determine whether an inventory count by the entity is necessary in the circumstances to obtain sufficient appropriate audit evidence.

Application Material

19. The Project Team proposes to repurpose and reorganize application material previously presented to the Board at the September 2026 meeting, or develop application material to provide guidance about the auditor’s key considerations in determining whether an inventory count by the entity is “necessary in the circumstances” (also see paragraph 16).

Matters for IAASB Consideration

- 1. The Board is asked for its views on:
 - (a) The revised structure of Proposed ISA 501 (Revised) as it relates to inventory and requirements in paragraphs 3A, 3B and 7A; and
 - (b) The potential application material that may be developed to support them as described in paragraphs 10, 13 and 19.

¹⁰ Proposed ISA 330 (Revised), paragraphs 14–26

¹¹ Proposed ISA 330 (Revised), paragraphs 25–26

¹² ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor’s Report*, paragraph 13

Appendix

Extracts of the Draft September 2026 IAASB Minutes of Meeting – ISA 500 Series Project as It Relates to the Restructuring of Proposed ISA 501 (Revised)

Decision

1. The Board supported retaining Proposed ISA 501 (Revised) as a separate standard and the overall direction for restructuring the standard as it relates to inventory.

Directions

2. The IAASB provided the following directional feedback on the restructuring presented:
 - (a) Clarify that the entity's approach to establishing the existence and condition of inventory at the date of the financial statements should not, by itself, determine the auditor's response to obtain sufficient appropriate audit evidence.
 - (b) Establish a stronger linkage to ISA 315 (Revised 2019) and Proposed ISA 330 (Revised).
 - (c) For circumstances in which the entity does not conduct a year-end inventory count or cycle counts:
 - (i) Clarify that under this third category the entity ordinarily relies on controls related to its perpetual inventory system to satisfy itself as to the existence and condition of inventory (e.g., may relate to automated inventory systems used by the entity or may be driven by the nature of the inventory).
 - (ii) Leverage the construct used in ISA 570 (Revised 2024) for requirements addressing the auditor's request for management to extend its period of assessment. In particular, consider circumstances in which the auditor may conclude that additional procedures, including inventory observation or independent test counts, are necessary notwithstanding the entity's approach.
 - (iii) Reconsider whether the requirements and application material have the appropriate level of detail and specificity.
 - (d) Enhance the requirement and related application material addressing unforeseen circumstances for which the auditor is unable to attend the entity's inventory count. Board members shared various suggestions on how to enhance the requirement, including by:
 - (i) Adding a requirement similar to paragraph 5 that applies if the auditor's alternative inventory count date is at a date other than the date of the financial statements.
 - (ii) Replacing "alternative date" with "at a date as close as practicable to the year-end date."
 - (iii) Clarifying what qualifies as unforeseen circumstances.