

ASA 501
(October 2009)

Auditing Standard ASA 501
*Audit Evidence—Specific
Considerations for Inventory
and Segment Information*
(Revised and Redrafted)

Issued by the **Auditing and Assurance Standards Board**

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Auditing and Assurance Standards Board

Obtaining a Copy of this Auditing Standard

This Auditing Standard is available on the Auditing and Assurance Standards Board (AUASB) website: www.auasb.gov.au.

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ISSN 1833-4393

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PREFACE

Reasons for Issuing Auditing Standard ASA 501 *Audit Evidence—Specific Considerations for Inventory and Segment Information* ~~(Revised and Redrafted)~~

The Auditing and Assurance Standards Board (AUASB) issues Auditing Standard ASA 501 *Audit Evidence—Specific Considerations for Inventory and Segment Information* pursuant to the requirements of the legislative provisions and the Strategic Direction explained below.

The AUASB is an independent statutory board of the Australian Government established under section 227A of the *Australian Securities and Investments Commission Act 2001*, as amended (ASIC Act). Under section 336 of the *Corporations Act 2001*, the AUASB may make Australian Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislative Instruments Act 2003*.

Under the Strategic Direction given to the AUASB by the Financial Reporting Council (FRC), the AUASB is required to have regard to any programme initiated by the [International Auditing and Assurance Standards Board \(IAASB\)](#) for the revision and enhancement of the [International Standards on Auditing \(ISAs\)](#) and to make appropriate consequential amendments to the Australian Auditing Standards. Accordingly, the AUASB has decided to revise and redraft the Australian Auditing Standards using the equivalent redrafted ISAs.

The equivalent [international](#) standard is ~~International Standard on Auditing~~, ISA 501 *Audit Evidence—Specific Considerations for Selected Items*, issued by the ~~International Auditing and Assurance Standards Board (IAASB)~~, which contains sections on Inventory, Litigation and Claims and Segment Information.

The AUASB has decided to continue to issue ASA ~~508-502~~ ~~(Revised and Redrafted)~~ *Audit Evidence—Specific Considerations for Litigation and Claims* as a separate Auditing Standard, rather than as part of ASA 501. The main reason for this decision is that the extant standard, ASA 508 *Enquiry Regarding Litigation and Claims*, contains additional Requirements and guidance that the AUASB considers important to carry forward in Australia.

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Accordingly, ASA 501 ~~(Revised and Redrafted)~~ covers Inventory and Segment Information, while ASA ~~508-502~~ ~~(Revised and Redrafted)~~ covers Litigation and Claims.

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Draft

Main Features

This Auditing Standard establishes ~~mandatory~~ Requirements and provides Application and Other Explanatory Material regarding specific considerations by the auditor in obtaining sufficient appropriate audit evidence with respect to certain aspects of inventory and segment information in an audit of a financial report.

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This Auditing Standard:

- (a) ~~d~~Describes the procedures to be performed by the auditor, when inventory is material to the financial report, to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory;
- (b) ~~d~~Describes the auditor’s responsibilities in relation to attendance at physical inventory counting;
- (c) ~~d~~Describes the auditor’s responsibilities when inventory under the custody and control of a third party is material to the financial report; and
- (d) ~~d~~Describes the requirements in respect of obtaining sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

QA

AUASB Information Note

~~The IAASB has announced completion of the “Clarity” project. While all conforming amendments known at the time of issuing the Exposure Draft are incorporated into the proposed Standard, readers are advised that the AUASB may decide to make further conforming amendments and other editorial changes.~~

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AUTHORITY STATEMENT

The Auditing and Assurance Standards Board (AUASB) makes this Auditing Standard ASA 501 *Audit Evidence—Specific Considerations for Inventory and Segment Information* ~~(Revised and Redrafted)~~ pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*.

This Auditing Standard is to be read in conjunction with ASA 101 *Preamble to Australian Auditing Standards*, which sets out the intentions of the AUASB on how the Australian Auditing Standards, operative for financial reporting periods commencing on or after 1 January 2010, are to be understood, interpreted and applied. [This Auditing Standard is to be read also in conjunction with ASA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards.](#)

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Dated: 27 October 2009

M H Kelsall
Chairman - AUASB

AUDITING STANDARD ASA 501

Audit Evidence—Specific Considerations for Inventory and Segment Information (~~Revised and Redrafted~~)

Application

- Aus 0.1 This Auditing Standard applies to:
- (a) an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with of the *Corporations Act 2001*; and
 - (b) an audit of a financial report, or a complete set of financial statements, for any other purpose.
- Aus 0.2 This Auditing Standard also applies, as appropriate, to an audit of other historical financial information.

Operative Date

- Aus 0.3 This Auditing Standard is operative for financial reporting periods commencing on or after 1 January 2010.

Introduction

Scope of this ~~ASA Auditing Standard~~

1. This Auditing Standard deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence in accordance with ASA 330 (~~Revised and Redrafted~~),¹ ASA 500 (~~Revised and Redrafted~~)² and other relevant Australian Auditing Standards, with respect to certain aspects of inventory and segment information in an audit of a financial report.

Effective Date

2. [Deleted by the AUASB. Refer Aus 0.3]

¹ See ASA 330 (~~Revised and Redrafted~~) *The Auditor's Responses to Assessed Risks*.

Objective

3. The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the:
 - (a) Existence and condition of inventory; and
 - (b) [Deleted by the AUASB. Refer ASA 508-502 (Revised and Redrafted) *Audit Evidence—Specific Considerations for Litigation and Claims*]
 - (c) Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

Requirements

Inventory

4. If inventory is material to the financial report, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:
 - (a) Attendance at physical inventory counting, unless impracticable, to: (Ref: Para. A1-A3)
 - (i) Evaluate management’s instructions and procedures for recording and controlling the results of the entity’s physical inventory counting; (Ref: Para. A4)
 - (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 the entity’s final inventory records to determine whether they accurately reflect actual inventory count results.

² See ASA 500 (Revised and Redrafted) *Audit Evidence*.

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5. If physical inventory counting is conducted at a date other than the date of the financial report, the auditor shall, in addition to the procedures required by paragraph 4 [of this Auditing Standard](#), perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial report are properly recorded. (Ref: Para. A9-A11)
6. If the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor shall make or observe some physical counts on an alternative date, and perform audit procedures on intervening transactions.
7. If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor shall modify the opinion in the auditor's report in accordance with ASA 705 [\(Revised and Redrafted\)](#).³ (Ref: Para. A12-A14)
8. If inventory under the custody and control of a third party is material to the financial report, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:
 - (a) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity. (Ref: Para. A15)
 - (b) Perform inspection or other audit procedures appropriate in the circumstances. (Ref: Para. A16)

Litigation and Claims

- 9.-12. [Deleted by the AUASB. Refer ASA [508-502 \(Revised and Redrafted\)](#) *Audit Evidence—Specific Considerations for Litigation and Claims*]

Segment Information

13. The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in

³ See ASA 705 [\(Revised and Redrafted\)](#) *Modifications to the Opinion in the Independent Auditor's Report*.

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accordance with the applicable financial reporting framework by:
(Ref: Para. A26)

- (a) Obtaining an understanding of the methods used by management in determining segment information, and:
(Ref: Para. A27)
 - (i) Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and
 - (ii) Where appropriate, testing the application of such methods; and
- (b) Performing analytical procedures or other audit procedures appropriate in the circumstances.

* * *

Application and Other Explanatory Material

Inventory

Attendance at Physical Inventory Counting (Ref: Para. 4(a))

- 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 report 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. Matters relevant in planning attendance at physical inventory counting (or in designing and performing audit procedures pursuant to paragraphs 4-8 of this Auditing Standard) include, for example:
- The risks of material misstatement related to inventory.
 - The nature of the internal control related to inventory.
 - Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
 - The timing of physical inventory counting.
 - Whether the entity maintains a perpetual inventory system.

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- 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. ASA 600 ~~(Revised and Redrafted)~~⁴ deals with the involvement of other auditors and accordingly may be relevant if such involvement is with regards to attendance of physical inventory counting at a remote location.
- Whether the assistance of an auditor's expert is needed. ASA 620 ~~(Revised and Redrafted)~~⁵ deals with the use of an auditor's expert to assist the auditor to obtain sufficient appropriate audit evidence.

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 inventory counting include whether they address, for example:

- The application of appropriate control activities, for example, collection of used physical inventory count records, accounting for unused physical inventory count records, and count and re-count procedures.
- 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 cut-off date.

⁴ See ASA 600 ~~(Revised and Redrafted)~~ *Special Considerations—Audits of a Group Financial Report (Including the Work of Component Auditors)*.

⁵ See ASA 620 ~~(Revised and Redrafted)~~ *Using the Work of an Auditor's Expert*.

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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 cut-off 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.

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

- A6. Inspecting inventory when attending physical inventory counting assists the auditor in ascertaining the existence of the inventory (though not necessarily its ownership), and in identifying, for example, obsolete, damaged or ageing 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 inventory and tracing items selected from the physical inventory to management's count records, provides audit evidence about the completeness and the 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.

Physical Inventory Counting Conducted Other than At the Date of the Financial Report (Ref: Para. 5)

- A9. For practical reasons, the physical inventory counting may be conducted at a date, or dates, other than the date of the financial report. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the effectiveness of the design, implementation and maintenance of controls over changes in inventory determines whether the conduct of physical inventory counting at a date, or dates, other than the date of the financial report is appropriate for audit purposes. ASA 330

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(Revised and Redrafted) establishes requirements and provides guidance on substantive procedures performed at an interim date.⁶

- A10. Where a perpetual inventory system is maintained, management may perform physical counts or other tests to ascertain the reliability of inventory quantity information included in the entity's perpetual inventory records. In some cases, management or the auditor may identify differences between the 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. Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded include:
- Whether the perpetual inventory records are properly adjusted.
 - Reliability of the entity's perpetual inventory records.
 - Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records.

Attendance at Physical Inventory Counting Is Impracticable (Ref: Para. 7)

- A12. In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. 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 ASA 200 (Revised and Redrafted),⁷ 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.

⁶ See ASA 330, (Redrafted) paragraphs 22-23.

⁷ See ASA 200 (Revised and Redrafted) *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*, paragraph A48.

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- A13. In some cases where attendance 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 inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.
- 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. In such cases, ASA 705 (Revised and Redrafted) requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.⁸

Inventory under the Custody and Control of a Third Party

Confirmation (Ref: Para. 8(a))

- A15. ASA 505 (Revised and Redrafted)⁹ establishes requirements and provides guidance for performing external confirmation procedures.

Other Audit Procedures (Ref: Para. 8(b))

- A16. Depending on the circumstances, for example where information is obtained that raises doubt about the integrity and objectivity of the third party, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include:
- Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, 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.
 - Requesting confirmation from other parties when inventory has been pledged as collateral.

⁸ See ASA 705 (Revised and Redrafted) paragraph 13.

⁹ See ASA 505 (Revised and Redrafted) *External Confirmations*.

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Litigation and Claims

A17.-A25. [Deleted by the AUASB. Refer ASA [508-502 \(Revised and Redrafted\)](#) *Audit Evidence—Specific Considerations for Litigation and Claims*]

Segment Information (Ref: Para. 13)

A26. Depending on the applicable financial reporting framework, the entity may be required or permitted to disclose segment information in the financial report. The auditor's responsibility regarding the presentation and disclosure of segment information is in relation to the financial report taken as a whole. Accordingly, the auditor is not required to perform audit procedures that would be necessary to express an opinion on the segment information presented on a stand-alone basis.

Understanding of the Methods Used by Management (Ref: Para. 13(a))

A27. Depending on the circumstances, example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:

- Sales, transfers and charges between segments, and elimination of inter-segment amounts.
- Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.
- The allocation of assets and costs among segments.
- Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

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Conformity with International Standards on Auditing

This Auditing Standard conforms with the Inventory and Segment Information sections (paragraphs 1-8, 13, A1-A16 and A26-A27) of International Standard on Auditing ISA 501 *Audit Evidence—Specific Considerations for Selected Items* ~~(Redrafted)~~, issued by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC).

The other paragraphs of ISA 501 relating to Litigation and Claims (paragraphs 9-12 and A17-A25) are covered by ASA ~~508-502~~ *Audit Evidence—Specific Considerations for Litigation and Claims* ~~(Revised and Redrafted)~~.

The AUASB has decided to continue to issue ASA ~~508-502~~ ~~(Revised and Redrafted)~~ as a separate Auditing Standard. The main reason for this decision is that the extant standard, ASA 508 *Enquiry Regarding Litigation and Claims*, contains additional Requirements and guidance that the AUASB considers important to carry forward in Australia.

This Auditing Standard contains all the Requirements and guidance contained in ISA 501 relating to Inventory and Segment Information. Paragraphs that have been added to this Auditing Standard (and do not appear in the text of the equivalent ISA) are identified with the prefix “Aus”.

Compliance with this Auditing Standard enables compliance with the Inventory and Segment Information sections of ISA 501.