Introduction

The pandemic coronavirus (COVID-19) has caused significant disruptions in the business operations of companies. These disruptions also pose significant accounting and auditing challenges. Amongst those challenges, one of the challenges for the companies with year-end 31 March 2020 is to conduct a physical inventory count. This could be due to significant health and safety concerns, travel restrictions, lockdown, etc.

Inventory count – Key considerations

Management of a company is required to establish 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.

Further Company Auditor’s Report Order (CARO), 2016 requires auditors to comment on ‘Whether at reasonable intervals the management has conducted physical verification of inventory and if any material discrepancies were noticed on physical verification, whether it has been accounted for in books of accounts.

When inventory is material to the financial statements, Standard on Auditing (SA) 501, Audit Evidence - Specific Considerations requires an auditor to obtain sufficient and appropriate audit evidence regarding the existence and condition of inventory by:

- Attendance at physical inventory counting, unless impracticable to:
  - Evaluate management’s instructions and procedures for recording and controlling the results of the company’s physical inventory counting
  - Observe the performance of management’s count procedure
  - Inspect the inventory
  - Perform test counts and
- Performing audit procedures over the company’s final inventory records to determine whether they accurately reflect actual inventory count results.

Current situation – COVID-19

The COVID-19 outbreak could create a number of potential challenges for management of a company to conduct, and an auditor to attend inventory counts. It is possible that the outbreak may make inventory count challenging, in some cases, impracticable and including attendance by auditors. This may involve companies to re-visit their inventory count strategy and have a discussion with the audit committee, those charged with governance.
Possible situations that could arise due to the outbreak are as follows:

- **Management does not conduct an inventory count on the balance sheet date:** There could be a situation when management of a company believe it is not feasible to conduct a physical inventory count, for example, when the locations where inventory is held are closed and warehouse employees are confined to their homes due to a government imposed lockdown. In this situation, management should inform the auditors and those charged with governance the rationale of not conducting the inventory count.

  If auditors, audit committee and those charged with governance conclude that management’s explanations appear to be reasonable in the circumstances, then management would need to consider other possibilities e.g. whether it is possible to delay the count to a time when restrictions are lifted, or concerns reduced.

  However, if it is concluded that management’s explanations do not appear to be reasonable in the circumstances, then there could be an impact on audit, including risk assessment and auditor’s ability to obtain sufficient appropriate audit evidence. If there are management-imposed scope limitation then auditor would need to communicate this to audit committee and those charged with governance.

- **Physical inventory conducted at a date other than the date of financial statements:** In case the physical count of inventory would be conducted at a date other than the date of financial statements, then, information relating to changes in inventory between the count date and the date of financial statements would be crucial. An entity would need to ensure the effectiveness of the design, implementation and maintenance of controls over changes in inventory to determine whether the conduct of physical inventory counting at a date, or dates, other than the date of the financial statements is appropriate for audit purposes of an entity. Additional consideration should be given to following factors:
  - Whether the perpetual inventory records are properly adjusted
  - Reliability of the entity’s perpetual inventory records

  - Reasons for differences between the information obtained during the physical count and the perpetual inventory records.

### Impracticable for an auditor to attend physical count

Due to various restrictions imposed currently as part of measures to combat COVID-19 outbreak, in certain cases it could be difficult for auditors to physically attend the inventory count organised by a company. In that case, management would need to demonstrate controls over inventory movements and an auditor should be able to test and place reliance on them.

Auditors would need to perform alternative audit procedures to obtain audit evidence as to the existence and condition of inventory, for example, observing a current physical inventory count and reconciling it to the opening inventory quantities or inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting.

If the challenges persist and auditors are not able to obtain sufficient appropriate audit evidence by performing alternative procedures, then depending on the pervasiveness of the scope limitations, this may result in a modification of opinion in an auditor’s report.

If auditors had attended last inventory count, then management would need to provide information to help auditors perform roll forward procedures. Roll forward procedures for the intervening period may include, among others, the following:

- Vouching purchases of inventory during the intervening period to and from perpetual records
- Vouching sales of inventory during the intervening period to and from perpetual records
- Performing substantive analytical procedures to evaluate sales, gross margin percentages, inventory turnover and/or days sales in inventory
- Testing inventory sales and purchases for proper cut-off at period end
- Testing the accuracy of the inventory reconciliation to the general ledger at period end, including tests of reconciling items.
As the year-end is approaching, companies should at the earliest decide upon the course of action for performing inventory counts, if not done yet. Given the practical challenges, it becomes imperative for auditors and companies to understand the relevant audit considerations and take appropriate actions. This would require a detailed discussion with the audit committee, those charged with governance and the auditors to develop a future course of action. In any of the situation, management would need to provide adequate information along with the controls placed for inventory count and to enable auditors to obtain sufficient and appropriate audit evidence.

An auditor would need to consider whether roll-forward procedures could provide sufficient appropriate audit evidence. Generally, as the length of the roll-forward period increases, the persuasiveness of the audit evidence the previous inventory count combined with roll-forward procedures provides for existence of physical inventory quantities at the reporting date decreases. This is because an auditor can only sample transactions that were recorded during the roll-forward period, and there is a risk that inventory movements may not have been recorded. This risk increases as the roll-forward period gets longer. In addition, roll-forward procedures do not provide evidence as to the condition of inventory at the reporting date.

**Use of technology in inventory count**

In certain situations where physical attendance by auditors is not possible, they may be able to observe the count remotely via video call with the help of technology. An auditor would need to ensure the security on these applications. The auditors would need to understand the technological and practical constraints to observing an inventory count remotely. If auditors are observing a count remotely, they would need to perform the same procedures as if attending in person.

**Conclusion**