

STOCK

The audit of stock is important as this is likely to be a material balance sheet area. It can pose problems for the auditor as a result of its nature and potential material value on the balance sheet.

AUDIT OBJECTIVES FOR STOCK

The following table demonstrates the audit objectives for stock and how these are related to the financial statement assertions relevant to this balance sheet area.

Financial statement assertion	Audit objective
Existence and occurrence	– Recorded purchases and sales represent stocks bought and sold – Stock in the balance sheet physically exists
Completeness	– All purchases and sales are recorded – All stock at year-end is included in the balance sheet
Rights and obligations	– The entity has rights to stock recorded in the period and at the year-end
Accuracy, classification and valuation	– Costs are accurately determined in accordance with accounting standards – Stock is recorded at year-end at the lower of cost and net realisable value

Financial statement assertion	Audit objective
Cut-off	– All purchases and sales of stocks are recorded in the correct period
Assertions relating to presentation and disclosure (Classification and understandability Completeness Accuracy and valuation)	– Stock is properly classified in the accounts – Disclosures relating to classification and valuation are adequate and in accordance with accounting standards

ACCOUNTING FOR STOCK

The valuation and disclosure rules for stock are laid down in SSAP9 : Stocks and Long Term Contracts. *Stock should be valued at the lower of cost and net realisable value*

AUDIT PROCEDURES FOR STOCK

Audit procedures for stock are set out in the table below.

AUDIT PLAN: STOCK	
COMPLETENESS	• Complete the disclosure checklist to ensure that all the disclosures relevant to stocks have been made. • Trace test counts to the detailed stock listing. • Where stock is held in third party locations, physically inspect this stock or review confirmations received from the third party and match to the general ledger. • Compare the gross profit % to the previous year or industry data.
EXISTENCE	• Observe the physical stock count (see section 4 for details of attendance at the stock count).
RIGHTS AND OBLIGATIONS	• Verify that any stock held for third parties is not included in the year-end stock figure by being appropriately segregated during the stock count. • For any 'bill-and-hold' stock (i.e. where the stock has been sold but is being held by the entity until the customer requires it), identify such stock and ensure that it is segregated during the stock count so that it is not included in the year-end stock figure.

AUDIT PLAN STOCK

	• Confirm that any stock held at third party locations is included in the year-end stock figure by reviewing the stock listing.
VALUATION AND ALLOCATION	• Obtain a copy of the stock listing and agree the totals to the general ledger. • Cast the stock listing to ensure it is mathematically correct. • Vouch a sample of stock items to suppliers' invoices to ensure it is correctly valued. • Where standard costing is used, test a sample of stock to ensure it is correctly valued. • For materials, agree the valuation of raw materials to invoices and price lists. • Confirm that an appropriate basis of valuation (eg FIFO) is being used by discussing with management. • For labour costs, agree costs to wage records. • Review standard labour costs in the light of actual costs and production. • Reconcile labour hours to time summaries. • Make inquiries of management to ascertain any slow-moving or obsolete stock that should be written down. • Examine prices at which finished goods have been sold after the year-end to ascertain whether any finished goods need to be written down. • If significant levels of finished goods remain unsold for an unusual period of time, discuss with management and consider the need to make provision. • Compare the gross profit % to the previous year or industry data. • Compare raw material, finished goods and total stock turnover to the previous year and industry averages. • Compare stock days to the previous year and industry average. • Compare the current year standard costs to the previous year after considering current conditions. • Compare actual manufacturing overhead costs with budgeted or standard manufacturing overhead costs.
CUT-OFF	• Note the numbers of the last GDNs and GRNs before the year-end and the first GDNs and GRNs after the year-end and check that these have been included in the correct financial year.

AUDIT PLAN: STOCK

ACCURACY	• Obtain a copy of the stock listing and cast it, and test the mathematical extensions of quantity multiplied by price. • Trace test counts back to the stock listing. • If the entity has adjusted the general ledger to agree with the physical stock count amounts, agree the two amounts. • Where a continuous (perpetual) stock system is maintained, agree the total on the stock listing to the continuous stock records, using CAATs.
OCCURRENCE AND RIGHTS AND OBLIGATIONS	• Inquire of management and review any loan agreements and board minutes for evidence that stock has been pledged or assigned. • Inquire of management about warranty obligation issues.
CLASSIFICATION AND UNDERSTANDABILITY	• Review the stock listing to ensure that stock has been properly classified between raw materials, work-in-progress and finished goods. • Read the notes to the accounts relating to stock to ensure they are understandable.
ACCURACY AND VALUATION	• Review the financial statements to confirm whether the cost method used to value stock is accurately disclosed. • Read the notes to the accounts to ensure that the information is accurate and properly presented at the appropriate amounts.