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## Revision of "Extensions of auditing procedure" relating to inventories; Statement on auditing procedure, No. 36

American Institute of Accountants. Committee on Auditing Procedure

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STATEMENT ON  
AUDITING PROCEDURE

36

*Revision of  
"Extensions of Auditing Procedure"  
Relating to Inventories*

The independent auditor's procedures with respect to his client's determination of inventory quantities was the subject of a report entitled "Extensions of Auditing Procedure" which was issued by a Special Committee on Auditing Procedure and approved by a vote of the membership of the Institute in 1939.<sup>1</sup> This report stated, in part, the following:

That hereafter, where the independent certified public accountant intends to report over his signature on the financial statements of a concern in which inventories are a material factor, it should be generally accepted auditing procedure that, in addition to making auditing tests and checks of the inventory accounts and records, he shall, wherever practicable and reasonable, be present, either in person or by his representatives, at the inventory-taking and by suitable observation and inquiry satisfy himself as to the effectiveness of the methods of inventory-taking and as to the measure of

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<sup>1</sup> The Executive Committee of the Institute by resolution on April 29-30, 1966 approved "the issuance of statements on auditing procedure which may modify or revise pronouncements on matters of auditing, previously approved by members at annual meetings, as consistent with the authority granted to the committee on auditing procedure by the Council."

*Issued by the Committee on Auditing Procedure  
American Institute of Certified Public Accountants*

reliance which may be placed upon the client's representations as to inventories and upon the records thereof. . . .

In cases where the inventory is determined solely by means of a physical inventory at the end of the accounting period (or at a date prior or subsequent thereto but within a reasonable time thereof, with adequate records supporting the interim changes), it will ordinarily be necessary for the foregoing procedures to be followed at that time.

In cases where the concern maintains well kept and controlled perpetual inventory records supported by (1) a complete physical inventory at a date not coincident with the balance sheet date, or (2) physical inventories of individual items taken from time to time so that the quantity of each item on hand is compared with the inventory record for that item at least once in each year, it will be satisfactory to undertake the procedure outlined at any interim date or dates selected by the auditor, his purpose being to satisfy himself as to the credibility of the perpetual inventory records and whether they may be relied upon to support the inventory totals as shown on the balance sheet.

This report has generally been understood as requiring the client to make a complete physical count of all items each year in order for the independent auditor to satisfy himself by his tests as to inventory quantities within the meaning of generally accepted auditing standards.

In recent years some companies have developed inventory controls or methods of determining inventories, including statistical sampling, of sufficient reliability to make an annual physical count of each item of inventory unnecessary in certain instances. The purpose of this statement is to recognize this development.

Where a client's inventory control procedures or methods of determining inventories are highly effective, an accurate determination of inventory quantities may be made without a count of all items once each year. In such circumstances the independent auditor must satisfy himself that the client's procedures or methods are sufficiently reliable to produce results comparable to those which would be obtained by a complete physical in-

ventory each year. If statistical sampling methods are used by the client in the taking of the physical inventory, the independent auditor must be satisfied that the sampling plan has statistical validity, that it has been properly applied and that the resulting precision and reliability, as defined statistically,<sup>2</sup> are reasonable in the circumstances.

If the independent auditor is able to satisfy himself as set forth in the preceding paragraph and has carried out adequate inventory observation procedures (see paragraphs 16, 17 and 19 of Chapter 6 of Statements on Auditing Procedure No. 33) he has complied with generally accepted auditing standards and the disclosure requirement referred to in paragraph 27 of Chapter 10 of Statements on Auditing Procedure No. 33 does not apply.

*The statement entitled Revision of "Extensions of Auditing Procedure" Relating to Inventories was adopted unanimously by the twenty-one members of the committee.*

## NOTES

*Unless otherwise indicated, Statements on Auditing Procedure present the considered opinion of the twenty-one members of the committee on auditing procedure, reached on a formal vote after examination of the subject matter by the committee and the technical services division. Except where formal adoption by the Council or the membership of the Institute has been asked and secured, the authority of the statements rests upon the general acceptability of the opinions so reached.*

*The committee on auditing procedure is the senior technical committee of the Institute designated to express opinions on auditing matters. While it is recognized that general rules may be subject to exception, the burden of justifying departures from the committee's recommendations must be assumed by those who adopt other practices.*

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<sup>2</sup> See "Relationship of Statistical Sampling to Generally Accepted Auditing Standards, A Special Report by the Committee on Statistical Sampling of the American Institute of Certified Public Accountants," *The Journal of Accountancy*, July 1964. Copies are available on request from the AICPA.

## COMMITTEE ON AUDITING PROCEDURE (1965-66)

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