

How to Audit Inventory

3rd Edition

By Steven M. Bragg, CPA

Table of Contents

Chapter 1 – Auditing Inventory	1
Learning Objectives	1
Introduction.....	1
The Nature of Inventory.....	1
Auditor Objectives.....	2
Auditing Characteristics of Inventory	2
Inventory Process Flow	4
Inventory Costing.....	6
Inventory Fraud.....	7
Incorrect Receipt Fraud.....	7
Product Replacement Fraud.....	7
Diversion of Scrap Payments	8
Inventory Falsification	8
Accidental Errors.....	10
Inherent Risk Assessment.....	10
Material Misstatement Assessment	11
Substantive Procedures	12
Evaluate the Count Plan.....	14
Verify the Cutoff.....	14
Observe the Physical Count.....	16
Test the Count	17
Evaluate the Costing Methodology	18
Test Inventory Costing	18
Reconcile Inventory to General Ledger.....	20
Investigate Legal Encumbrances.....	20
Investigate Possible Impairments.....	20
Conduct Analytical Procedures.....	21
Gross Profit Method	22
Review Presentation	23
Auditing a Periodic Inventory System	23
Auditing a Perpetual Inventory System.....	24
Mixed Systems.....	24
Internal Controls Used by the Client	24
Activities for an Initial Audit.....	32
Summary	33
Review Questions	34
Review Answers	35
Chapter 2 – The Physical Inventory Count.....	37
Learning Objectives	37
Introduction.....	37
The Physical Inventory Count.....	37
Summary	40
Review Questions	41
Review Answers	42

Table of Contents

Chapter 3 – The Lower of Cost or Market Rule.....	43
Learning Objectives	43
Introduction.....	43
Lower of Cost or Market Rule.....	43
Inventory Translation Adjustment	46
Summary	47
Review Questions	48
Review Answers	49
Chapter 4 – Inventory Cost Layering	51
Learning Objectives	51
Introduction.....	51
Inventory Cost Layering Overview.....	51
The First in, First Out Method.....	52
The Last in, First Out Method.....	54
The Weighted Average Method.....	55
Summary	56
Review Questions	58
Review Answers	59
Glossary	61
Index.....	63