

CASE STUDY REGARDING THE ASSISTANCE OF AN AUDITOR TO A STOCK COUNT

IOANA BUFAN, ANDRA CORNEAN

WEST UNIVERSITY OF TIMISOARA, FACULTY OF ECONOMICS AND BUSINESS
ADMINISTRATION, 16 J.H.PESTALOZZI STREET, TIMISOARA, 300115, ROMANIA
ioana_diana_bufan@yahoo.com; cornean_andra_05@yahoo.com

Abstract:

Whatever the nature of the elements of the stock count or departments in which the elements are located, the auditor should perform their work according to certain rules and will perform the stock count in order to answer certain questions in the check list.

The members of the audit team selected certain types of goods from the department's stock count lists following quantities in order to identify physical stock, a process called "list to floor". Its opposite process is called "floor to list" and it involves random selection of certain types of goods that will be identified on the lists by the audit team members.

As a conclusion, the assistance to the stock count procedures by the auditor is essential during the audit assignment. It has a direct impact on the opinion expressed by the auditor due to the assertion regarding the existence related to the financial situations.

Key words: stock count, audit assignment, opinion, assertion, procedures, financial statements

JEL classification: M40, M41, M42

1. GENERAL FACTS

The Commercial Enterprise Baile Felix Spa Treatment decides on the 4th of November 2011 to perform an overall stock count of all assets and liabilities of the enterprise. The period in which the stock count takes place is from 15.11.2011 to 31.12.2011, and its reference date is the 29th of December 2011. The entity's auditor of S.C.T.B. Felix S.A. was notified by e-mail and fax about the schedule of the general patrimony's stock count, in order to determine the participation program of the audit team to the stock count.

At the department which is subject of this case study, namely the "International Hotel ", the stock count started on the 3rd of December 2011 and ended on the 18th of December 2011. Since the stock count started before the 31th of December 2011, the Finance - Accounting Department will update the stock count results to the 31th of December 2011 so that both in inventory book and in the annual financial statements will be enclosed the correct values of the goods counted and registered in the lists, updated with the inputs and outputs of goods during the period 03.12.2011 - 31.12.2011.

For the entire enterprise it was nominated one central commission and seven subcommittees which have performed the stock count of fixed assets, inventory, fuel, merchandise, packages, cash, expenses, checks with limited amount and others.

2. DESCRIPTION OF THE STOCK COUNT

Whatever the nature of the elements of the stock count or departments in which the elements are located, the auditor should perform their work according to certain

rules and will perform the stock count in order to answer certain questions (Table no.1), the answers to these questions will help the auditor to prepare the audit report.

The first question that any auditor must take into consideration is whether or not the entity has written instructions for the stock count and if these instructions were sent (under nominal signature) to the person in charge with the stock count. To answer these questions, the auditor should receive the Stock Count Decision, this document usually includes all the necessary instructions in its content.

Another essential problem in the operation of the stock count is the coverage in its process of all places of storage and all kinds of stocks (stocks located at client's premises/ stocks belonging to third parties). In the department "International Hotel ", the auditor has not been provided with information regarding the existence of items belonging to third-parties. Also, there are not any articles available to third parties. It is also important for the process of the stock count that the fixed assets are arranged in such a manner that allows the counting and facilitate stocktaking. Identification of stocks should be made by using labels, plates etc. At the department "International Hotel" fixed assets and inventory are arranged corresponding to the requests of the stock count, but are not labeled, which does not allow their precise identification. Also, inventory and other items were not significant or moved to another location.

The existence of a double counting is also an essential element that the auditor has to verify. In the stock count of the department "International Hotel" such a procedure has not been used by the stock count commission. Another important aspect is the presence in the stock count team, on the one hand, of a person who does not take part of the department's staff, and on the other hand, at least one person who has sufficient technical knowledge to identify stocks. At the department "International Hotel" both requirements about the stock count committee are met.

Also, the auditor should verify that the subject of depreciation, damaged and missing articles was well understood (those elements that can reduce the value of counted items). At the department "International Hotel" there is a legally granted percentage of perishableness. There are still high-risk inventory that might record minuses above the permissible level calculated according to internal rules.

One of the most important aspects that is mandatory for the auditor to investigate is the existence of stock count statement. Such a document should be taken to each manager at the beginning of the stock count.

Another problem is the advancement/ movement of the stock count procedure. It is recommended to be done using a geographic advancement. At the department "International Hotel" the stock count was not made by using this method. The auditor must also verify that the stock count records are completed in ink, no gaps and erasures. The documents must show the procedure applied when the team reports an error in the stock count. In the department "International Hotel" the lists are completed in "pencil" so they can be easily corrected.

The auditor must also note if:

- items were moved during the stock count;
- deliveries from suppliers occurred during stock count;
- shipments of goods to customers occurred during stock count;
- incoming and outgoing stock is based on documents;
- buffer zones were designed in order to receive deliveries during stock count or allow customer shipment (or outputs) during the stock count, and if this area is supervised.

At the department "International Hotel" there weren't movements during the stock count. Another very important aspect is the confirmation of stocks with customers and suppliers using account statements. This procedure was followed by S.C.T.B. Felix S.A. When the same item is stored in several different places, the auditor should identify all of them in order to make an exhaustive stock count. This could be then

compared with the final listed stock amount, and if this is impossible, he must carefully note the position and ensure that it can be individualized on the final lists of stocks. In the department "Hotel International" this thing could be easily done for inventory and fixed assets count.

The auditor should verify based on survey the contents of the closed packages, the quantity of products and write down the articles that appear used or damaged. This procedure was applied to the objects in the warehouse of materials from the "International Hotel". The auditor should also follow up if the quality checking items is done (content of packages, analysis of liquid and chemical samples) and if notation of used or damaged items is done. At the end of the stock count, the auditor should make photocopies of some stock count lists (or all lists in order to ensure that changes have not been made, when this procedure is needed). If it is not possible to make photocopies, the auditor will highlight certain items from these lists in order to track their correct reporting on the financial statements at the end of the year. The auditor will verify the preparation of the stock count:

- the way in which tests were made between the physical stock and the script stock (if there were made changes during the stock count);
- how the differences were calculated;
- how it was decided to recover the missing amounts revealed during the stock count and the way records were made for the additional articles found (including how to justify these differences).

The stock count of the inventory, fixed assets and other materials at the department "International Hotel" has taken place inside and outside the building.

3. THE AUDITOR'S ASSISTANCE TO THE STOCK COUNT

Customer's employees performed the stock count by counting. The audit firm's employees assisted to the stock count of the fixed assets and inventory in the same location, the "International Hotel". The audit team observed how the stock count was performed, they selected some items from the inventory in order to test the counting done by customer's stock count team. The audit team also made a second count of different goods, from various departments - participating in the physical stock count.

The members of the audit team selected certain types of goods from the department's stock count lists following quantities in order to identify physical stock, a process called "list to floor". Its opposite process is called "floor to list" and it involves random selection of certain types of goods that will be identified on the lists by the audit team members. This count is confronted with the evidence enclosed in the list of the stock count. These procedures are applied to stocks for which the auditor was unable, physically, to participate to the stock count because it took place simultaneously in different areas of the department.

Observation and counting tests that were conducted revealed the following weaknesses of the procedures:

- the stock count commissions include people responsible with the management of those departments;
- the stock count was not properly marked.

There are requests for identifying slow moving stocks, damaged stocks and the expiry date of some goods. All these should be marked on the stock count list. Some inventory cannot be physically identified, being very old, should be proposed for disposal.

Physical quantities that were counted are recorded into the system. The actual quantity of each product and its value are both compared to the existing one from the system. The stock count was conducted simultaneously from factual to the physical

script (for some stocks) allowing immediate identification of differences from the factual to the actual script. Each difference has been seriously investigated and all the products from a sort were recounted. A member of the audit team participated in the recount of differences together with the client.

After completing the stock count, the auditor answers to a series of questions that can be found in the Physical Inventory Questionnaire. Working Memorandum is completed after the auditor's participation to the stock count.

The **objective** of an audit assignment of the financial statements is to achieve a reasonable level of assurance and the auditor can express a positive opinion according to which the financial statements are correctly prepared according to the relevant accounting rules and instructions.

To express an opinion, the auditors use one of the following expressions or an equivalent:

- The financial statements offer an accurate view of ...;
- The financial statements present faithfully in all the significant aspects....

If during the assignment the auditor's work is limited due to the circumstances or the occurrence of a disagreement with the management regarding the content of financial statements, the auditor cannot express an opinion without reserves, and the opinion will change into one with reserves, or according to each case, impossibility of expressing an opinion or a contrary opinion.

Through his opinion, the auditor provides a high assurance (reasonable) that the financial statements are free of errors. This certification is expressed in view of the audit requirements related to the credibility of an assertion made by a party for the use of another party.

Participation of the auditor to the stock count during the audit assignment is essential to support the assertion regarding the existence. However, sometimes this is not a possible fact, which can significantly influence the opinion expressed by the auditor.

If the auditor will not participate to the stock count, the audit report will have an opinion with reserves, which will be presented in front of the opinion paragraph.

Enterprise: **S.C.T.B. BAILE FELIX S.A.**

Unit: **INTERNATIONAL HOTEL– fixed assets, inventory**

Year: **2011**

Table 1

Check List

Stage	Checkings to be performed	Ref. Working sheet	YES	NO or N/A	Notes
1	Checking if there are written instructions related to the stock count and if those have been given: - to the person in charge with the stock count - to the persons performing the stock count Were these instructions subject of comments or explanations made by the supervisors during a kick-off meeting?		Yes		The entity has issued written instructions on 04.11.2011. Those have been given to the staff involved in the stock count.
2	Are there included all locations of stocks and all types of stocks? - stocks from third parties - stocks belonging to third parties?		Yes		There are no stocks at/belonging to a third party.

3	Does the current placement allow an easy performance of the stock count?		Yes		
4	Was it made an identification of the stocks? How? (labels etc.)			No	
5	Is there a double check? Which is the procedure if there are differences?			No	
6	Is there a permanent stock count?			N/A	
7	Does the stock count team include at least a person who is not employee of the warehouse or team member of the stock count group?		Yes		
8	Have the team members performing the stock count received clear instructions about the work they will perform?		Yes		See point 1 of the Check List.
9	Is there at least one person with technical skills and knowledge within every team able to identify the stocks?		Yes		
10	Are the stock count techniques well defined?		Yes		Counting
11	Was it made clear and understood the procedure for depreciation, missing items, etc?		Yes		There is a legally allowed percentage for various losses.
12	Initial statement of each warehouse responsible have been obtained before starting the stock count?		Yes		
13	Has the warehouse responsible given a written statement in case he was aware of differences existent in the stocks?		Yes		
14	Will it be made a stock count of the items' quality? Will the used or damaged goods will be mentioned?		Yes		
15	Will it be made a stock count based on geographical performance of the stocks?			No	In most cases.
16	Are the persons performing the stock count ignoring the theoretical quantity of the stocks?		Yes		
17	In the case of double stock counts is the second team ignoring the results obtained by the first stock count?			N/A	
18	Which are the agreed mentions made on the stocks in order to confirm that the first and then the second counting have been performed?			N/A	
19	Tare the stock count files filled in using ink without corrections and missing information? Which procedure will be used when the stock count team makes errors on the reported figures?		Yes		Initially, all files will be filled in with pencils so that correction could be made latter on when the case.

20	Were there organized few zone from where deliveries can be made during the stock count process? Is this area supervised?			N/A	
21	Where there items movements during the stock count process?			N/A	
22	If at point no. 20 the answer is "YES" which was the procedure to avoid the double stock count or the omission of the items?			N/A	
23	All entries or deliveries are made based on such a specific document?		Yes		
24	If at point 23 the answer is YES, mention few numbers of the specific documents showing entries or deliveries before and after the stock count operations in order to check their correct accounting when the accounts checking will be made.			N/A	
25	If the answer at point no. 23 is NOT, what has been made in order to decide the right owner of the goods included in the stock count?			N/A	
26	Were there made deliveries from suppliers during the stock count? If YES, which were the measures taken to identify those deliveries?			No	
27	Were there goods delivered to clients during the stock count? If YES, which were the means agreed in order to identify these deliveries?			No	
28	How were treated the items placed in custody?			N/A	
29	How were the goods placed at third parties treated?			N/A	
30	Were there been made confirmation requests?		Yes		
31	Which was the result of the compared documents related to the entry and the delivery documents (see question no. 18) and the stock files?			N/A	
32	Are the results of the counting procedure compared against the stock files by different persons other than the stock count team or the warehouse responsible?		Yes		See the audit file.
33	Is there made a previous check up before each substantial correction of the stock files?			N/A	
34	Is the list with all differences being communicated to the Management?		Yes		See audit file.
35	When there are several stocks of the same item in different places, identify those places and make an exhaustive		Yes		

	stock count which can be eventually compared to the final amount mentioned on the stock list or if this is not possible, carefully note the item's position recorded and make sure that it can be identified on the final sock list.				
36	Check : - content of the closed packages - quantity of products and note the damaged items or those looking already used.		Yes		For the inventory in the warehouse.
37	After finishing the stock count, make copies of few inventory files or of all, in order to make sure that no changes are made before the accounts were checked. If copies cannot be made, make at least mentions of few elements or items included in those lists so that they can allow you to follow up the correct reporting of the items on the year end situations.		Yes		
38	Do check the way in which the stock count has made the evaluation of: - the differences between the counted items and the existent written statement - the way of calculating the differences noted during the stock count - the way decided to be used for recuperation of the differences noted for the missing items or the items found in a bigger quantity than expected			N/A	

Memo of Physical Stock Count

Date of the stock count: December 3rd, 2011

Date of count: December 3rd, 2011 – no inward or outward movements were made during the stock count

Stock count of: Object of inventory, Fixed Assets – **International Hotel**

Team members – staff of “X” Audit : Irimie Raluca; Lupas Anca.

Contact person: Popa Maria

A) Planning phase

1. *Location* – stock counting is performed inside and outside the building.
2. *Stocks at third parties or taken in custody* – no information regarding existence of goods from third parties was provided to us. There are no goods placed at third parties as well.
3. *Identified risks:*
 - The stocks which have been counted were not marked or moved to a different location;
 - The fixed assets and inventory objects are not labelled and that does not allow an exact identification of the every item;
 - The stock count have not been performed based on geographical advancement;

- There are goods owning a high risk of being registered with losses, over the legally allowed calculated reserve according to internal norms; this is due to their very old age, difficulty to be sold or low movement.

4. *Analysis of the instructions regarding the stock count* – the entity has issued oral & written instructions related to the stock count.

Conclusion:

The stock count procedure of the entity is suitable.

B) Stock counting

The client staff have performed the inventory by counting all items.

Staff of „X” Audit has assisted to the stock count of the fixed assets, inventory objects located in the same place-International Hotel.

We have followed up the modality of performing the stock count, have selected few articles for being counted and to be object of the tests performed by the client’s teams.

Consequently, the tests have revealed the following weaknesses of the procedures:

- the stock count teams included among their staff the persons usually in charge with the stock counts;
- the stock count has not been noted in a suitable manner.

Conclusion:

The physical stock count was performed in accordance with the current legal procedures and regulations.

C) After stock count

For some goods, the stock count was simultaneously made (physical and written lists checking) and this procedure has allowed us to immediately identify the differences between the written lists and the real stocks. There are some very old objects of inventory, which should be written off.

4. CONCLUSIONS

The audit purpose is to verify and certify that the annual financial statements by a qualified and independent professional in order to express an opinion regarding the reliability of the data contained in the annual financial statements.

The auditor’s assistance to the stock count is crucial in an audit assignment. It has a direct impact on the opinion expressed by the auditor, due to the existence assertion on the annual financial statements. Also, the stock count data can be carriers of significant risks and to eliminate them, the auditor participation is mandatory.

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