

**ENTITY NAME:** \_\_\_\_\_

## **INVENTORIES**

We need to understand:

- How and by whom the transactions are initiated
- The accounting processing involved from initiation of a transaction to its inclusion in the general ledger or financial statements, including how the computer is used to process data
- The supporting documents involved, including accounting records and journals, source documents, and electronic means involved in the processing of the transactions
- The documents and reports generated by the accounting system

### **SECTION A**

#### **INTERNAL CONTROL OBJECTIVES**

- Inventories are purchased only with proper authorization.
- Inventories received are recorded correctly as to account, amount, and period.
- Inventories are adequately safeguarded.
- Inventory balances recorded in the accounting records are evaluated periodically by comparison with actual quantities on hand (i.e., physical inventory).
- Costs are assigned to inventories in accordance with the stated valuation method.
- Obsolete and slow-moving inventories are promptly detected and provided for.
- Carrying values of inventories are periodically compared to net realizable value and appropriate adjustments are made.

#### **POTENTIAL ERRORS AND FRAUD**

- Entries are not properly reflected in general ledger inventory accounts for purchases.
- Inaccuracies in the detailed perpetual inventory records result in unnecessary materials purchased, inventory overstock, and obsolescence.
- Undetected physical loss or deterioration of inventory occurs.
- Scrap sales are not monitored or reported.
- Nonexistent inventory items are included in periodic physical count.
- Unauthorized adjustment of inventory records is made to conceal misappropriation of assets.
- Inventory records are manipulated to improve performance picture.

**UNDERSTANDING OF ACCOUNTING SYSTEM**

1. How and by whom are the transactions initiated?

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2. Describe the source documents that support the transactions.

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3. Describe the computer media that is used in the processing of accounting information.

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4. Describe the documents and reports generated by the accounting system.

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5. Describe the accounting processing, records, and files (including how frequently they are updated) that are used to process the transactions, including how transactions are reflected in journals of original entry and in the general ledger.

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## SECTION B

### FURTHER UNDERSTANDING OF CONTROL ACTIVITIES

#### Physical Control, Reconciliations, and Valuation

	Yes	No	N/A
1. Are all types of inventory adequately safeguarded (e.g., guards, alarms) and insured?	_____	_____	_____
2. Are employees with access to inventory bonded, if appropriate?	_____	_____	_____
3. Are offsite inventories stored in bonded warehouses, if applicable?	_____	_____	_____
4. Are employees who are responsible for custody of inventory independent of inventory recording and accounting functions?	_____	_____	_____
5. Are receiving reports for all incoming materials prepared for the accounting department to be matched with purchase orders and invoices?	_____	_____	_____
6. Are issuances made only on signed requisitions?	_____	_____	_____
7. Are physical inventories taken:			
a. At the end of the fiscal year?	_____	_____	_____
b. Periodically during the year?	_____	_____	_____
8. Are written instructions and procedures followed for inventory counts and is compliance with them checked?	_____	_____	_____
9. Are inventory counts supervised by qualified persons following adequate written instructions and procedures?	_____	_____	_____
10. Are inventory custodians independent of billing and recordkeeping?	_____	_____	_____
11. Are documents issued in prenumbered order and controlled for:			
a. Receiving?	_____	_____	_____
b. Materials requisitions?	_____	_____	_____
12. Are priced inventory sheets numerically controlled and verified as to:			
a. Quantities?	_____	_____	_____
b. Unit cost?	_____	_____	_____
c. Extensions and footings?	_____	_____	_____
13. Are costs, extensions, and footings of the inventory listings verified by a second person?	_____	_____	_____

	Yes	No	N/A
14. Is a periodic review made as to potential overstock, slow-moving, and obsolete items by comparing quantities on hand with historical usage?	_____	_____	_____
15. Are adequate controls in place for sale or reuse of scrap or salvaged materials?	_____	_____	_____
16. Is the carrying value of inventory periodically compared to net realizable value, and are adjustments recorded if necessary?	_____	_____	_____
17. Are records maintained for inventory on consignment or in outside warehouses and periodically reconciled to reports received from these parties?	_____	_____	_____
18. Are all inventory adjustments documented, and do they require management approval?	_____	_____	_____

## Perpetual Records

	Yes	No	N/A
1. Are perpetual inventory records maintained?	_____	_____	_____
2. Do the perpetual records show:			
a. Quantities?	_____	_____	_____
b. Unit costs?	_____	_____	_____
c. Aggregate dollar values?	_____	_____	_____
3. Are the perpetual records kept by employees who have no access to the inventory?	_____	_____	_____
4. Are significant differences between physical counts and perpetual records investigated promptly?	_____	_____	_____
5. Are perpetual records reconciled periodically to the controlling accounts in the general ledger?	_____	_____	_____
6. Are the perpetual records adjusted to the physical inventory counts at least once a year, and are such adjustments approved by a responsible employee?	_____	_____	_____
7. Are perpetual inventory records checked regularly by cycle counts? If yes:	_____	_____	_____
a. Are all classes of inventory subjected to cycle counts?	_____	_____	_____
b. Are significant differences between cycle counts and perpetual records investigated and reconciled?	_____	_____	_____
c. Are inventory adjustments documented and do they require management approval?	_____	_____	_____

## Cost Accounting Processes (utility construction or similar activities)

	Yes	No	N/A
1. Are material costs charged to job orders or material usage accounts?			

	Yes	No	N/A
	_____	_____	_____
2. Are production labor costs charged to job orders or departmental expense accounts based on payroll records or job tickets?	_____	_____	_____
3. Is overhead charged to job orders or departments based on measure of activity (e.g., direct labor hours or dollars)?	_____	_____	_____
4. Is work-in-process increased for materials placed in production?	_____	_____	_____
5. Is work-in-process relieved and the accounts charged based on completed production orders or inspection reports?	_____	_____	_____
6. Is the application of materials, labor, and overhead to work-in-process reviewed regularly for reasonableness and consistency?	_____	_____	_____
7. Are standard cost variances regularly analyzed and allocated to inventory?	_____	_____	_____