

AU Section 901

Public Warehouses—Controls and Auditing Procedures for Goods Held *

Source: SAS No. 1, section 901; SAS No. 43.

Issue date, unless otherwise indicated: November, 1972.

Introduction

.01 This section discusses controls of a public warehouse, the procedures of its independent auditor with respect to goods in the warehouse's custody, and auditing procedures performed by the independent auditor of the owner of goods in the warehouse.¹ [As amended, effective after August 31, 1982, by Statement on Auditing Standards No. 43.]

General Considerations

.02 The management of a business has the responsibility for the proper recording of transactions in its books of account, for the safeguarding of its assets, and for the substantial accuracy and adequacy of its financial statements. The independent auditor is not an insurer or guarantor; his responsibility is to express a professional opinion on the financial statements he has audited.² [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

Summary of Recommendations

.03 The Committee recommends that the independent auditor of the warehouseman:

- a. Obtain an understanding of controls, relating to the accountability for and the custody of all goods placed in the warehouse and perform tests of controls to evaluate their effectiveness.
- b. Test the warehouseman's records relating to accountability for all goods placed in his custody.
- c. Test the warehouseman's accountability under recorded outstanding warehouse receipts.
- d. Observe physical counts of the goods in custody, wherever practicable and reasonable, and reconcile his tests of such counts with records of goods stored.

* Title revised, February 1997, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 78.

¹ This section reports the conclusions of a 1966 study of the AICPA Committee on Auditing Procedure on the accountability of warehousemen for goods stored in public warehouses. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

² See section 110.

- e. Confirm accountability (to the extent considered necessary) by direct communication with the holders of warehouse receipts.

The independent auditor should apply such other procedures as he considers necessary in the circumstances. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982. Paragraph subsequently renumbered by the issuance of Statement on Auditing Standards No. 48, July 1984.]

.04 Warehousing activities are diverse because the warehoused goods are diverse, the purposes of placing goods in custody are varied, and the scope of operations of warehouses is not uniform. The independent auditor has the responsibility to exercise his judgment in determining what procedures, including those recommended in this report, are necessary in the circumstances to afford a reasonable basis for his opinion on the financial statements.³ [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

.05 The following sections of this report describe those aspects of warehousing operations of primary concern to independent auditors, suggest elements of internal control for warehousemen, and offer the Committee's recommendations as to procedures of the independent auditor. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

Public Warehouse Operations

Types of Warehouses

.06 A warehouse may be described as a facility operated by a warehouseman whose business is the maintaining of effective custody of goods for others. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

.07 Warehouses may be classified functionally as terminal warehouses or field warehouses:

Terminal Warehouse. The principal economic function of a terminal warehouse is to furnish storage. It may, however, perform other functions, including packaging and billing. It may be used to store a wide variety of goods or only a particular type of commodity.

Field Warehouse. A field warehouse is established in space leased by the warehouseman on the premises of the owner of the goods or the premises of a customer of the owner. In most circumstances all or most of the personnel at the warehouse location are employed by the warehouseman from among the employees of the owner (or customer), usually from among those who previously have been responsible for custody and handling of the goods. Field warehousing is essentially a financing arrangement, rather than a storage operation. The warehouse is established to permit the warehouseman to take and maintain custody of goods and issue warehouse receipts to be used as collateral for a loan or other form of credit.

Warehouses may be classified also by types of goods stored. Foods and other perishable products may be stored in refrigerated warehouses, constructed and equipped to meet controlled temperature and special handling requirements. Certain bulk commodities, such as various agricultural products and chemicals,

³ See section 326.

are stored in commodity warehouses; these warehouses often are designed and equipped to store only one commodity, and fungible goods frequently are commingled without regard to ownership. A wide variety of goods, usually not requiring special storage facilities, is stored in general merchandise warehouses. Some warehouses confine their activities to storing furniture, other household goods, and personal effects. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

Warehouse Receipts

.08 A basic document in warehousing is the warehouse receipt. Article 7 of the Uniform Commercial Code regulates the issuance of warehouse receipts, prescribes certain terms that must be contained in such receipts, provides for their negotiation and transfer, and establishes the rights of receipt holders. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

.09 Warehouse receipts may be in negotiable form or non-negotiable form and may be used as evidence of collateral for loans or other forms of credit. Goods represented by a negotiable warehouse receipt may be released only upon surrender of the receipt to the warehouseman for cancellation or endorsement, whereas goods represented by a non-negotiable receipt may be released upon valid instructions without the need for surrender of the receipt. Other important ways in which the two kinds of receipts differ concern the manner in which the right of possession to the goods they represent may be transferred from one party to another and the rights acquired by bona fide purchasers of the receipts. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

.10 Since goods covered by non-negotiable receipts may be released without surrender of the receipts, such outstanding receipts are not necessarily an indication of accountability on the part of the warehouseman or of evidence of ownership by the depositor. Since goods are frequently withdrawn piecemeal, the warehouseman's accountability at any given time is for the quantity of goods for which receipts have been issued minus the quantities released against properly authorized withdrawals. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

.11 Article 7 of the Uniform Commercial Code, in addition to provisions with respect to the issuance and contents of warehouse receipts, contains provisions with respect to, among other things, the storage and release of warehoused goods, the standard of care to be exercised by the warehouseman, warehouseman's liability, and liens for the warehouseman's charges and expenses and the manner in which they may be enforced. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

Government Regulation

.12 There are various other statutes and regulations, applicable in special situations, relating to the rights and duties of warehousemen and the operation of warehouses. Among the more important are (a) the United States Warehouse Act and the regulations adopted thereunder by the Department of Agriculture, providing for licensing and regulation of warehouses storing certain agricultural commodities, (b) the regulations adopted by commodity exchanges licensed under the United States Commodity Exchange Act, providing

for issuance and registration of receipts and licensing and regulation of warehouses, and (c) the Internal Revenue Code and the Tariff Act of 1930, and regulations adopted thereunder, relating respectively to United States Revenue Bonded Warehouses and United States Customs Bonded Warehouses, providing for licensing, bonding, and regulation of such warehouses. In addition, there are statutes and regulations in various states relating to licensing, bonding, insurance, and other matters. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

The Warehouseman

Controls

.13 Goods held in custody for others are not owned by the warehouseman and, therefore, do not appear as assets in his financial statements. Similarly, the related custodial responsibility does not appear as a liability. However, as in other businesses, the warehouseman is exposed to the risk of loss or claims for damage stemming from faulty performance of his operating functions. Faulty performance may take the form of loss or improper release of goods, improper issuance of warehouse receipts, failure to maintain effective custody of goods so that lenders' preferential liens are lost, and other forms. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

.14 The recommendation herein that the independent auditor of the warehouseman obtain an understanding of relevant controls and perform tests of controls to evaluate their effectiveness is based upon the important relationship of such controls to the custodial responsibilities of the warehouseman, which are not reflected in his financial statements. Significant unrecorded liabilities may arise if these custodial responsibilities are not discharged properly. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982. Revised, April 1989, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards Nos. 53 through 62.]

.15 Whether and to what extent the suggested controls that follow may be applicable to a particular warehouse operation will depend on the nature of the operation, of the goods stored, and of the warehouseman's organization. Appropriate segregation of duties in the performance of the respective operating functions should be emphasized.

Receiving, Storing, and Delivering Goods

Receipts should be issued for all goods admitted into storage.

Receiving clerks should prepare reports as to all goods received. The receiving report should be compared with quantities shown on bills of lading or other documents received from the owner or other outside sources by an employee independent of receiving, storing, and shipping.

Goods received should be inspected, counted, weighed, measured, or graded in accordance with applicable requirements. There should be a periodic check of the accuracy of any mechanical facilities used for these purposes.

Unless commingling is unavoidable, such as with fungible goods, goods should be stored so that each lot is segregated and identified with the pertinent warehouse receipt. The warehouse office records should show the location of the goods represented by each outstanding receipt.

Instructions should be issued that goods may be released only on proper authorization which, in the case of negotiable receipts, includes surrender of the receipt.

Access to the storage area should be limited to those employees whose duties require it, and the custody of keys should be controlled.

Periodic statements to customers should identify the goods held and request that discrepancies be reported to a specified employee who is not connected with receiving, storing, and delivery of goods.

The stored goods should be physically counted or tested periodically, and quantities agreed to the records by an employee independent of the storage function; the extent to which this is done may depend on the nature of the goods, the rate of turnover, and the effectiveness of other internal control structure policies and procedures.

Where the goods held are perishable, a regular schedule for inspection of condition should be established.

Protective devices such as burglar alarms, fire alarms, sprinkler systems, and temperature and humidity controls should be inspected regularly.

Goods should be released from the warehouse only on the basis of written instructions received from an authorized employee who does not have access to the goods.

Counts of goods released as made by stock clerks should be independently checked by shipping clerks or others and the two counts should be compared before the goods are released.

Warehouse Receipts

Prenumbered receipt forms should be used, and procedures established for accounting for all forms used and for cancellation of negotiable receipts when goods have been delivered.

Unused forms should be safeguarded against theft or misuse and their custody assigned to a responsible employee who is not authorized to prepare or sign receipts.

Receipt forms should be furnished only to authorized persons, and in a quantity limited to the number required for current use.

The signer of receipts should ascertain that the receipts are supported by receiving records or other underlying documents.

Receipts should be prepared and completed in a manner designed to prevent alteration.

Authorized signers should be a limited number of responsible employees.

Insurance

The adequacy, as to both type and amount, of insurance coverage carried by the warehouseman should be reviewed at appropriate intervals.

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

Additional Controls for Field Warehouses

.16 As indicated earlier, the purpose of field warehousing differs from terminal warehousing. Operating requirements also may differ because a field

warehouseman may operate at a large number of locations. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

.17 In field warehousing, controls are applied at two points: the field location and the warehouseman's central office. At the field location, the controls as to receipt, storage, and delivery of goods and issuance of warehouse receipts generally will comprise the controls suggested above, with such variations as may be appropriate in light of the requirements, and available personnel, at the respective locations. Only non-negotiable warehouse receipts should be issued from field locations, and the receipt forms should be furnished to the field locations by the central office in quantities limited to current requirements. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

.18 The central office should investigate and approve the field warehousing arrangements, and exercise control as to custody and release of goods and issuance of receipts at the field locations. Controls suggested for the central office are the following:

Consideration of the business reputation and financial standing of the depositor.

Preparation of a field warehouse contract in accordance with the particular requirements of the depositor and the lender.

Determination that the leased warehouse premises meet the physical requirements for segregation and effective custody of goods.

Satisfaction as to legal matters relative to the lease of the warehouse premises.

Investigation and bonding of the employees at the field locations.

Providing employees at field locations with written instructions covering their duties and responsibilities.

Maintenance of inventory records at the central office showing the quantity (and stated value, where applicable) of goods represented by each outstanding warehouse receipt.

Examination of the field warehouse by representatives of the central office. These examinations would include inspection of the facilities, observation as to adherence to prescribed procedures, physical counts or tests of goods in custody and reconciliation of quantities to records at the central office and at field locations, accounting for all receipt forms furnished to the field locations, and confirmation (on a test basis, where appropriate) of outstanding warehouse receipts with the registered holders.

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

Procedures of the Independent Auditor

.19 The Committee recommends that the independent auditor of the warehouseman:

- a. Obtain an understanding of controls, relating to the accountability for and the custody of all goods placed in the warehouse and perform tests of controls to evaluate their effectiveness.

- b. Test the warehouseman's records relating to accountability for all goods placed in his custody.
- c. Test the warehouseman's accountability under recorded outstanding warehouse receipts.
- d. Observe physical counts of the goods in custody, wherever practicable and reasonable, and reconcile his tests of such counts with records of goods stored.
- e. Confirm accountability (to the extent considered necessary) by direct communication with the holders of warehouse receipts.

The independent auditor should apply such other procedures as he considers necessary in the circumstances. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

.20 The auditor's procedures relating to accountability might include, on a test basis, comparison of documentary evidence of goods received and delivered with warehouse receipts records, accounting for issued and unissued warehouse receipts by number, and comparison of the records of goods stored with billings for storage. In some circumstances, the auditor may consider it necessary to obtain confirmation from the printer as to the serial numbers of receipt forms supplied. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

.21 In the case of a field warehouseman where goods are stored at many scattered locations, the independent auditor may satisfy himself that the warehouseman's physical count procedures are adequate by observing the procedures at certain selected locations. The amount of testing required will be dependent upon the effectiveness of both design and operation of controls. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

.22 The confirmation of negotiable receipts with holders may be impracticable, since the identity of the holders usually is not known to the warehouseman. Confirmation with the depositor to whom the outstanding receipt was originally issued, however, would be audit evidence of the accountability for certain designated goods. It should be recognized, too, that as to both negotiable and non-negotiable receipts, confirmation may not be conclusive in the light of the possibility of issued but unrecorded receipts. In some circumstances, it may be desirable to request confirmations from former depositors who are not currently holders of record. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

.23 The independent auditor should review the nature and extent of the warehouseman's insurance coverage and the adequacy of any reserves for losses under damage claims. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

Controls and Auditing Procedures for Owner's Goods Stored in Public Warehouses

.24 The following paragraphs provide guidance on the controls for the owner of the goods and on the auditing procedures to be employed by his

independent auditor. [As amended, effective after August 31, 1982, by Statement on Auditing Standards No. 43.]

Controls

.25 The controls of the owner should be designed to provide reasonable safeguards over his goods in a warehouseman's custody. Ordinarily, the controls should include an investigation of the warehouseman before the goods are placed in custody, and a continuing evaluation of the warehouseman's performance in maintaining custody of the goods. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

.26 Among the suggested controls that may be comprehended in an investigation of the warehouseman before the goods are placed in his custody are the following:

Consideration of the business reputation and financial standing of the warehouseman.

Inspection of the physical facilities.

Inquiries as to the warehouseman's controls and whether the warehouseman holds goods for his own account.

Inquiries as to type and adequacy of the warehouseman's insurance.

Inquiries as to government or other licensing and bonding requirements and the nature, extent, and results of any inspection by government or other agencies.

Review of the warehouseman's financial statements and related reports of independent auditors.

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

.27 After the goods are placed in the warehouse, suggested controls that may be applied periodically by the owner in evaluating the warehouseman's performance in maintaining custody of goods include the following:

Review and update the information developed from the investigation described above.

Physical counts (or test counts) of the goods, wherever practicable and reasonable (may not be practicable in the case of fungible goods).

Reconcilement of quantities shown on statements received from the warehouseman with the owner's records.

In addition, he should review his own insurance, if any, on goods in the custody of the warehouseman.

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 43, August 1982.]

Procedures of the Independent Auditor

.28 Section 331.14 describes the procedures that the auditor should apply if inventories are held in public warehouses. [As amended, effective after August 31, 1982, by Statement on Auditing Standards No. 43.]