# Ems audit of maxall

Finance

However, an increase in cash could also be attributed to the collection of accounts receivable and not a new sales transaction. In addition, an increase in receivables account would indicate a possible sales on account transaction. On the other hand, an increase in receivables accounts could be due to the reinstatement or reversal of accounts receivable that had been written off. Accounts receivable are written off if there is a probability that a certain amount of receivables can no longer be collected because the customer may be absconded or has filed for bankruptcy in the courts2.

Was the substantive approach appropriately applied in EM's audit of Maxell?

Yes, the substantive approach appropriately was applied in EM's audit of Maxell. First, EM determined that a violation of the auditing principle that segregation of incompatible functions occurred. Auditing principles state that incompatible functions of recording, keeping, and approving should not be placed on the shoulders of one person. For, there is a stronger possibility of fraud to occur in the sales, receivables, cash accounts if one person handles two or three of the functions mentioned here. For example, the cashier can pocket the cash collected from the customer and make a fraudulent entry debiting bad debts expense of $100 and crediting accounts receivable of $100 so that the customer's account will be erased or written off. In short, there is greater audit risk in incompatible function scenes than when one person is the cashier, another person is the bookkeeper or accountant and a third person approves receivables write off.

Second, the external auditors set materiality levels of $35, 000 in the sales/accounts receivable area in 2001. the external auditors set materiality levels of $50, 000 for the year 2002. Materiality is defined as the amount that would affect the decision-making activities of users of the financial statements. The financial statement users include the board of directors, stockholders, suppliers, creditors, bank customers, government taxation and legal agencies, community. For example, the nonrecording of sales transaction amounting to $10 would surely not affect the decision of the users if the total sales reported in the income statement is $2, 000, 000. On the other hand, a debit to sales and accounts receivable accounts in December 2001 of $5, 000 when the delivery of the inventory took place on January 2, 2002, would affect the decision-making activities of the users of the financial statements if the amount of the total receivable is $12, 000.

In terms of planning, the auditors, EM, were right not to pinpoint that the internal control was weak and that more time must be spent to gather more evidence to substantiate that the financial statements are not fairly presented. Fairly presented is the best audit report opinion to give for it means that the financial statements are fair to everyone because only the material subsidiary accounts are examined, vouched, observed, confirmed, and the like.

The external auditors, EM, were right in planning to gather audit evidence based on material levels above in order to save on the audit client's audit expenses. The external auditors were right in gathering confirmation of fifty-five to sixty percent of the accounts receivables amount to $4, 146, 591 for 2001 and $26, 952, 431 in 2002. Positive confirmation is a better strategy when the accounts receivable amount of each account customer is material. The negative confirmation is a better strategy when the accounts receivable of each account customer is not material. The received confirmations amounting to $1, 900, 036 in 2001 and $14, 786, 239 in2002 will is the customer's confirmation that the accounts receivable listed in the accounts receivable ledger is correct or erroneous.

Likewise, the application of alternative procedures when confirmation letters were not received from the clients is in compliance with generally accepted auditing standards in the arena of audit evidence gathering. The alternative procedures include tracing the flow of transactions from inventory to sales on account of the collection of accounts receivables3.

Identify and discuss specific audit processes/procedures that the auditors) performed that were in accordance with Generally Accepted Auditing Standards

In addition to the audit processes/ procedures discussed in the prior question above, the auditors complied with GAAS by verifying that some sales on accounts were not recorded. For example, EM noticed that The Southwestern Accounts receivable of $370, 440 listed in the balance sheet as of December 31, 200s did not tally with the customer's confirmation that it had only an accounts receivable balance of $19, 426. Alternative procedures done by EM proved that the $370, 440 shipment from Maxall to Southwestern had arrived at the customer's destination after the cut off date of December 31, 2001.

Further, Em was right in making audit adjustment of increasing the 2002 sales and receivables amounts by $48, 310 because a sales transaction should only be recorded in the book of original entry (Journal) on the date of the actual delivery4.

CONCLUSION:

The auditing firm, EM, had complied with all facets of generally accepted auditing standards in the area of receivables, cash, and sales. They complied with the auditing procedures and programs in terms of audit risk, planning, materiality, and collection of evidence.