

APPENDIX 12C

ELECTRONIC DATA INTERCHANGE (EDI) SYSTEMS AND ACCOUNTS PAYABLE AUDITS

Rapid changes in information technology have had a great impact on how audits are conducted in various accounts. The CICA has documented some of these changes in an audit testing study, *Confirmation of Accounts Payable* (CICA, 1996). Although e-business was introduced in Chapter 7, this appendix provides a summary of the effects of a specific type of e-business, EDI systems, on accounts payable audits. EDI stands for electronic data interchange and is defined in the study as “an exchange of electronic business documents between economic trading partners, computer to computer, in a standard format.”

The significance of EDI for the audit approach to accounts payable is summarized in pages 35–40 of the study as follows (the numbers in the margins indicate paragraph numbers from the study):

Partnership with Suppliers

10 EDI has introduced a new way of doing business, that is, business in partnership. EDI implementation requires the support of customers and/or suppliers, and they must agree with the entity on how transactions will be carried out. With respect to purchases, the entity must enter into agreements with each of its suppliers willing to trade by EDI. Depending on the integration level of applications, discussions deal with the various documents to be exchanged, as well as supply, delivery, billing or payment methods. It becomes preferable for entities to buy a given product from a limited number of suppliers, and they will thus forge closer business relationships. In some cases, the partnership goes even further: the customer communicates the sales or production forecasts for a product to the supplier to help the latter plan for the supply of the product and improve customer service . . .

Elimination of Statements of Account

11 Given these new ties between partners, certain documents, such as statements of account currently issued by suppliers, are no longer useful. As accounts payable balances become less significant and purchase terms are set in agreements, the partners will probably no longer feel the need for documents that summarize transactions and balances. The elimination of statements of account, however, also eliminates reliable external audit evidence regarding accounts payable at the end of the accounting period cycle. Several of the substantive procedures the auditor normally uses to audit accounts payable are based on this evidence. To obtain the required audit evidence, the auditor must now perform procedures based on other forms of evidence...

Billing of Accounts Payable

13 Systems integration and partnerships with suppliers can also change the way goods are billed. For example, price information can be extracted from a price catalogue managed jointly by the trading partners and incorporated into their respective applications. In such a case, the supplier does not send an electronic invoice. The pricing of purchases is based on information contained in the electronic notice of receipt issued by the customer (or in the electronic notice of shipment issued by the supplier) and the price catalogue. The auditor can no longer use supplier invoices, which previously constituted external evidence, and will probably have to rely on the proper functioning of the pricing process. The auditor will most likely verify application controls (as well as manual and physical controls), for example, controls to access and/or modify the price catalogue...

Audit Approach*Importance of controls in an integrated EDI environment*

17 With EDI, entities depend more on computer systems, and while effective systems can lessen the risk of human error, the impact of any weakness in control may be magnified.

Moreover, the accuracy, authorization and completeness of data produced by integrated EDI systems are ensured mainly by programmed controls intended to prevent, rather than only detect, errors. It will be difficult to rely on evidence available essentially only in electronic form without auditing the functioning of controls—mainly programmed controls—which ensure the reliability and authenticity of such evidence.

- 18 The factors mentioned in the previous paragraph, the complexity of integrated EDI systems and the difficulty of implementing detection controls that involve external evidence can increase detection risk, and it is possible that an essentially substantive approach will no longer be efficient. . . . obtaining the assurance that control systems have operated effectively during the entire period, . . . will be necessary. . . . Since, in an integrated EDI environment, existing controls are, for the most part, electronic, the auditor will have to use computer-assisted audit techniques more frequently, for example, integrated test facilities, concurrent audit tools and embedded audit modules. In addition, tests of controls will probably have to be performed in real time and at different times during the period, so that the auditor can assess the effectiveness of internal control throughout the period and not only at one particular moment, such as the interim audit. In short, for entities whose EDI applications are integrated with other applications, it will likely be more effective to audit financial information using a control-based approach and computer-assisted audit techniques. . . .

Confirmation

- 24 One might question the usefulness of accounts payable confirmation in an integrated EDI environment. If statements of account from suppliers are not available, if the value of accounts payable is no longer material and if other procedures can be used to verify balances more effectively, the auditor might decide that accounts payable confirmation is unnecessary.
- 25 Where the combined inherent and control risk associated with accounts payable is high, the auditor may need to perform substantive procedures that will provide more reliable audit evidence than that gathered from the review of subsequent payments. Accounts payable confirmation could be used to attain that objective. The fact that a supplier may be unable to determine the account balance at a specific date could be a major problem. To overcome this difficulty, the auditor could ask the client whether an agreement could be reached with the suppliers whereby they would retain (for a certain period of time) balance-related data at the client's year-end date...
- 27 Eventually, auditors, too, will probably use EDI in the performance of their duties. Confirmation requests could then take the form of electronic documents, and be transmitted by EDI to suppliers. In turn, the suppliers will forward their responses to the auditor's electronic mailbox, possibly through a value-added network. If auditors are to use EDI to confirm accounts payable, however, a set of standardized electronic documents will have to be developed.

As noted in Chapter 7, EDI systems are more secure because they operate in private networks, not the public networks of the Internet. However, as equivalent security features evolve on the Internet, the advantages of EDI will become available at lower cost to smaller businesses in increasingly larger networks, creating virtual marketplaces. Hence, these EDI features should become more relevant to more audits over time.