

# THE RELEVANCE OF AUDITING IN A COMPUTERIZED ACCOUNTING SYSTEM

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**Abstract** - The world is changing faster than ever before as computer is affecting every sectors of the economy. Accounting profession is not left out of this change as the quality of information to be provided to users for decision making have to be improved on. This paper, therefore provide a detailed information about the concept of auditing to its relevance in a computerized accounting system. The papers also give a brief explanation on the terms computer, auditing, and computerized accounting system. This study also analyzed the procedure for auditing a computerized accounting system. The trend between manual and computerized accounting systems was also x-rayed in this paper. Based on the findings of this research, some recommendations were made. The study concludes with the statement that, although computerized accounting offers several more benefits than manual accounting, the function of manual accounting will never go away completely.

**Keywords** - Corporate World, Information Technology, Computerized Accounting System, Auditing.

## I. INTRODUCTION

The corporate world is getting more and more inclined towards the use of information technology (IT) and computer information system (CIS) in their daily operation for the purpose of processing of data, as well as decision making, and control of business organizations. Computers are now used in banks, hospitals, schools, home etc to keep records and to perform other operations.

Every company adopt the accounting system method of recording of transaction, because it is generally required that companies have to reveal certain financial and management information to the government and public users; and also because accounting is an indispensable tool in business decision making –process [Expert tutors and first class online study resources,2014]. With the development of information technologies, there were also developed computer products, such as software that make accounting easy for users of accounting information [Drew Nelson, 2012].

In the very limited field related to accounting matter alone, computer is used in tax collection, financial operation, insurance operation, inventory control, construction, cost estimation among others. This sudden change in the development of various organizations led to the change in the nature of audit evidence generated by each financial transaction [Drew Nelson. (2012)].

Auditing is important in an organization that have a computerized accounting system in order to satisfy the owners of the business (shareholders) that the financial statement presented to them is correct (present a true and fair view). Therefore, it is the external auditor that is required to carry out this duty of examining the transactions and reporting their findings to the shareholders and the public. Companies need to also satisfy themselves that financial statement is correct, before they can use

them to make decisions. They therefore, employ auditor as a staff of the organization (internal auditor) who perform independent appraisal function established within an organization as a service to the organization with the objective of assisting members of the organization in the effective discharge of their obligations.

The auditor is therefore required to possess reasonable knowledge of various hardware and software used in the organization in order to audit a computerized accounting system. The last few years have been an exciting time in the world of IT auditing as a result of the accounting scandals and increased regulations [Drew Nelson, 2012].

## II. DEFINITION

### A. Concept of Computer

Many reputable authors such as [Wallace B.,1998] believe that a computer is an advanced electronic device that takes raw data as input from the user and processes these data under the control of set of instructions (called program) and gives the result (output); and also saves output for the future use. It can process both numerical and non-numerical (arithmetic and logical) calculations. The basic components of a modern digital computer are: Input Device, Output Device and Central Processor.

Four functions about computer are:

**Input** (Data): Input is the raw information entered into a computer from the input devices. It is the collection of letters, numbers, images etc.

**Process:** Process is the operation of data as per given instruction. It is totally internal process of the computer system.

**Output:** Output is the processed data given by computer after data processing. Output is also called a result. We can save these results in the storage devices for the future use.

### **B. Concept of Auditing**

Auditing is the examination of financial statements by an independent certified accountant. It is a process of examining, scrutinizing financial records or documents prepared by a designated financial officer, in order to render an opinion on the correctness of the account prepared (whether it present a true and fair view).

In carrying out the above exercise, the Auditor will have to follow the various steps in auditing [Oladipupo A.O., 2003]:

- Examination of records (documentary)
- Verification of assets (physical)
- Questioning /information retrieval (oral)

Auditors analyze and compare accounting report and confirm documents, as well as verify conformity of a company's accounting records with established standards and regulations, (eg.US GAAP and IFRS).

### **C. Concept of Computerized Accounting System**

Computerized accounting system is the integration of different component systems to produce computerize books of accounts and computer generated accounting records and documents. It is a system in which accountants enter financial data into spreadsheets and other accounting software, and then mathematical algorithms compute the information into the necessary ledgers and financial statements. Computerized system also allows Accountants to create trending analysis, and report any variances quickly and accurately. Additionally, transactions from all company divisions are accessible through computerized accounting systems, giving Accountants better access to financial information [Expert tutors and first class online study resources,2014]

### **D. Concept of Manual Accounting System**

Manual accounting systems utilize several paper ledgers to record financial transactions. Companies have separate ledger for each part of the accounting system; such as accounts payable, accounts receivable and sales. Accountants then consolidate these ledgers into one general ledger, providing the balance for each ledger. The general ledger note book assists in creating financial statements [Expert tutors and first class online study resources 2014]

## **III. HISTORY OF INFORMATION TECHNOLOGY IN AUDITING**

Information technology auditing (IT auditing) began as electronic data process (EDP) auditing and developed largely as a result of the rise in technology in accounting systems, the need for IT control, and the impact of computer, and on the ability to perform attestation services. The last few years have been an exciting time in the world of IT auditing as a result of the accounting scandals and increased regulation. IT

auditing has had a relatively short, yet rich history when compared to auditing as a whole and remains an ever changing field.

The introduction of computer technology into accounting systems changed the way data was stored, retrieved and controlled. It is believed that the first use of a computerized accounting system was at general electric in 1954. During the time period of 1954 to the mid -1960s, the auditing profession was still auditing around the computer. At this time only mainframe computers were used and few people had the skills and abilities to program computers. This began to change in the mid-1960s with the introduction of new, smaller and less expensive machines. This increased the use of computers in business, and with it came the need for auditors to become familiar with EDP concepts in business. Along with the increase in computer use, came the rise of different types of accounting systems. The industry soon realized that they needed to develop their own software, and the first of the generalized audit software (GAS) was developed. In 1968, the American Institute of Certified Public Accountants (AICPA) had the Big Eight (now the big four) accounting firms participate in the development of EDP auditing. The result of this was the release of auditing & EDP. The book included how to document EDP audits and examples of how to process internal control reviews.

Around this time, EDP auditors formed the electronic data processing auditors association (EDPAA). The goal of the association was to produce guidelines, procedures and standards for EDP audits. In 1977, the first edition of control objectives was published. This publication is now known as control objectives for information and related technology [CobiT]. CobiT is the set of generally accepted IT control objectives for IT auditors.In1994, EDPAA changed its name to Information Systems Audit and control Association [ISACA].The period from the late 1960s through today has seen rapid changes in technology from the microcomputer and networking to internet; and with these changes came some major events that change IT auditing forever.

[<http://en.wikipedia.org/wiki/history>, 2014]

## **IV. AUDIT PROCESS FOR A COMPUTERIZED ACCOUNTING SYSTEM**

The audit process for a computerized accounting system involves five main steps: conducting the initial review (planning the audit); reviewing and assessing internal controls; compliance testing (testing the internal controls); substantive testing (testing the detailed data); and reporting (conclusions and findings). The auditor(s) should reach an understanding with the client concerning the scope and limitations of the audit from the very beginning.

The will facilitate the accomplishment of the audit objectives in an effective and efficient manner [6]:

1. Conduct a preliminary survey of the entity. This is preliminary work to plan how the audit should be conducted. The auditors gather information about the computerized accounting system that is relevant to the audit plan, including: a preliminary understanding of how the computerized accounting functions are organized; identification of the computer hardware and software used by the entity; a preliminary understanding of each significant accounting application processed by computer; and identification of planned implementation of new applications or revisions to existing applications and applicable controls.
2. Get and document an understanding of internal controls. There are two types of controls: general and application. General controls are those that cover the organization, management and processing within the computer environment but are not tied to particular applications. They should be tested prior to application controls, because if they are found to be ineffective, the auditor will not be able to rely on application controls. General controls include such things as proper segregation of duties, disaster plan, file backup, use of labels, access control, procedures for acquiring and implementing new programs and equipment, etc. Application controls relates to specific tasks performed by the system. They include input controls, processing controls, and output controls; and should provide reasonable assurance that the initiating, recording, processing and reporting of data are properly performed.
3. Perform compliance testing to determine whether the controls actually exist and function as intended. There are three general approaches to compliance testing: The test data approach, where the auditor has test transactions processed through the client's system and then compares the results to predetermined results; the integrated test facility approach, where dummy transactions are processed along with real transactions and compared o auditors predetermined results; and the parallel simulation approach, in which real transactions are processed through the client's system and also through a parallel system set up by the auditor using the same programs and the results are compared. The results of whichever of these test approaches is used should tell the auditor if the controls exist and are functioning properly.
4. Perform substantive testing to determine if the data is real. Auditors must obtain and evaluate evidence concerning management's assertions

about the financial statements. There are five assertions: completeness; rights and obligations; valuation or allocation; existence or occurrence; statement presentation and disclosures. The auditor uses the assertions to develop audit objectives and to design substantive tests. Substantive tests are tests of transactions and balances and analytical procedures designed to substantiate the assertions. The auditor must obtain sufficient competent evidential matter to provide a basis for an opinion regarding the financial statements under audit. If sufficient competent evidence cannot be obtained then an opinion cannot be issued.

5. Write the audit report to complete the audit. The audit report will contain an unqualified opinion, a qualified opinion or a disclaimer of opinion. An unqualified opinion means that the financial statements are presented fairly in accordance with generally accepted accounting practice (GAAP). A qualified opinion means the financial statements are presented fairly in accordance with GAAP except for some qualifying issues.

## V. TRENDS BETWEEN MANUAL ACCOUNTING AND COMPUTERIZED ACCOUNTING SYSTEMS

According to the article on [Expert tutors and first class online study resources,2014], while manual accounting system is tedious and time consuming, it offers some benefits. The ledgers are easy to review, and Accountants can make simple changes if necessary; individual accounts are easily reconciled because information is in a systematic order through each ledger. Accountants also have the benefit of physically handling each ledger and creating notes in customer accounts regarding any issues that need clarification or corrections.

However, computerized accounting offers several more benefits than manual accounting; accountants process more information quicker, formulas verify calculated totals, therefore errors are less common. Accounting systems also are customizable by industry, allowing accountants the opportunity to use preset templates for their general ledger. Accountants also can store several years of financial information with relative ease, giving them the opportunity to review previous year's information without sorting through stacks of paper ledgers.

Most companies will use a computerized accounting system for recording and presenting their financial information. This system allows companies to record business transactions accurately and generate financial reports quickly for management review [Mohammed S.R., 2004].

While the functions of manual accounting have changed, it will never go away completely.

Accountants must review the information presented on financial reports from the accounting system and ensure that it is accurate and valid. Accountants must also ensure that all financial information follows the Generally Accepted Accounting Principles and any other guidelines from regulatory agencies [Beirstaker, J.L. Bumaby, P., Thibodeau, J. 2001].

### **THE BENEFITS OF COMPUTERIZED ACCOUNTING SYSTEM**

According to the article on [6], the big difference in using the computer is the speed with which we can get accounting work done. In addition, we find that it is very easy to do accounting functions. Posting to the ledger, a tedious task of double entry, when done directly from the general ledger module, can be largely automated when done through special purpose modules like accounts payable or accounts receivable. With an accounts receivable module, you just need to enter the actual cash totals of items purchased and the software distributes these amounts to the general ledger so they become credits to corresponding revenue accounts. At the same time, an offsetting entry is made automatically to the accounts receivable account. [Braun, Robert L. and Davis, Harold E.,2003].

Accounts receivable, when computerized, can get your bills out the same day you have performed a service. An accounts receivable module prepares invoices and customer accounts, adds credit charges where appropriate, handles incoming payments, flags your attention to customers that are delinquent, and produces dunning notices. It allows you to have daily cash control. You get out the bills on time, yet you avoid errors such as billing a customer twice for the same time. The further advantage is that debits and credits are posted automatically to the general ledger, order entry, and in some instances inventory, once they are entered in accounts receivable.

Accounts payable, when computerized, will provide for purchase order control, invoice processing, payment selection and handling, check writing and control, cash-requirements and forecasting. It will also double check the accuracy of the vendors invoice, and some software systems will cross-check it against the purchase order and the inventory module.

Inventory control module has multiple functions, including tracking inventory for both costing and tax purposes, controlling purchasing (and the overall level of expenditure) and minimizing the investment in inventory (and subsequent loss of cash flow). The payroll module prepares and prints payroll checks, including all itemized deductions. It is integrated with the general ledger so you automatically set aside the correct amount for payroll deductions and withholding taxes. With a computer, one can receive a balance sheet, income statement or other accounting reports at a moments notice. [Braun, Robert L. and Davis, Harold E.,2003].

### **VII. DEMERITS OF A COMPUTERIZED ACCOUNTING SYSTEM**

There are actually several disadvantages of computerized accounting system. They may include the following:

- Not all software may be compatible for the things that you need to do when conducting your accounting business.
- The cost of computer and associated equipments are much more costly when compared to manual processing equipments, such as pens and pencils.
- Technological complexity of computer and its associated equipments makes it more difficult to learn and maintain when compared to equipments of manual information processing.
- The use of computers require additional infrastructure, such as power supply and software backup. These increases the chances of problems due to failure of these infrastructures.
- Failures of computer system can be more serious and difficult to correct, e.g. one scratch on a hard disk can make the complete data on the disk inaccessible. In comparison, manual system faults have comparatively limited impact.

### **VII. RECOMMENDATIONS**

Based on the findings of this research, the following recommendations were made:

- ❖ That Accountants should prepare financial statements by using computerized accounting system, as this will compel auditors to also use computer to audit, so that the reports prepared by auditors will be faster, accurate and more reliable.
- ❖ That Accountants should prepare financial statements by using computerized accounting system, as this will reduce the problems encountered with the manual accounting system to the barest minimum; and it will also make the auditors work more easier.
- ❖ That auditing professional bodies should organize seminars frequently for auditors, in order for them to be acquainted with new systems and innovations in software packages used in auditing computerized accounting system, as this will enable them do their work more effectively.
- ❖ That improvement should be made on established systems and procedures of computerized auditing, and questionnaires on internal control system as this will make

the work of Auditors easier and their reports more accurate and reliable.

## CONCLUSION

The study revealed that, the relevance of auditing in a computerized accounting system cannot be over emphasized in a society that, encompasses lots of people, business institutions etc. The introduction of computer technology into systems changed the way data is stored, retrieved and controlled.

It is believed that first use of a computerized accounting system was at general electric in 1954. During the time period of 1954- the mid 1960s, the auditing profession was still auditing around the computer. While the use of information technology (IT) in the business world has grown exponentially in the past two decades, the extent to which auditors have adopted IT such as computer assisted auditing techniques (CAAT) to meet this growth remains a big question. Knowledge of operations under audits, as well as computers is necessary for effective auditing when using computers. Computerized auditing cannot be carried out without cooperation by the organization under audit. Government agencies and board of audit in many countries in the world, such as Japan, and USA have been using computers in conducting audit for the purpose of swift and accurate processing of massive amount of data as well as drawing logical judgment, in an attempt to deal with computerized accounting systems. Manual and computerized accounting system Perform basically the same process; the accounting principles and concepts are the same, with differences lying in the

mechanics of the process [[http://www.Asosai.org/asosai\\_old/journal\\_1984/computerized\\_auditing.htm](http://www.Asosai.org/asosai_old/journal_1984/computerized_auditing.htm),2014].

The main goal of an audit is to perform thorough evaluation of a company's financial records and reports, and provide a company with improvement recommendations based on that evaluation. Although, computerized accounting offers several more benefits than manual accounting, the functions of manual accounting will never go away completely.

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