



CPA.com Whitepaper

Understanding the
**IMPORTANCE
OF VALIDATION**

in the audit
confirmation process.





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Introduction

The auditing world continues to evolve at a rapid pace with ever-changing regulations and new development of technologies. As such, auditing professionals know that the only constant within the profession is change itself. They also understand that amidst the complexities, it is they who are responsible to control the audit confirmation process and ensure reliability of audit evidence.

The pressure on auditors to maintain professional skepticism and control of the broad process has never been greater, which is why validation is an essential step in the audit workflow. Validation ensures that companies and individual respondents have been authenticated—supporting a thorough and reliable audit.

Validation is a fairly new component of the audit confirmation process. To better understand the mission-critical nature of this procedural element, it's important to understand the evolution of the audit process.

The evolution of the audit process

The audit confirmation process has been around for more than 100 years. Even with advances in technology, regulation changes, and ever-evolving complexities, a paper-and-mail system endures—even though the average confirmation requires 30+ steps, requires a 4-6 week turnaround per request, and averages a 43% lost or error rate. As a time-intensive process, you can see why the profession was ready for a change. In 1991, the introduction of the fax machine updated the process to allow for faxed confirmations, but still supported a predominantly manual and time-consuming process.

What we've learned over the years is that inherent in the paper-based process is inefficiency as well as one open to confirmation fraud. Consider that during the confirmation process the critical step of validating the location of where confirmations are sent or whether an individual in an authorized responder is often skipped. In turn, companies responding to confirmations and sending back private information never validate the authenticity of the CPA firm that they're responding to. In the end, what you have is a process where no one knows who's on the other end of the transaction.

Enter electronic confirmations...

As a much-needed replacement for a highly inefficient paper-and-mail process, in 2009 and 2010, those who set auditing standards approved the use of electronic confirmations. The advent of online confirmations did offer a much more efficient process, and has since become the standard. It also brought with it updated criteria to ensure the integrity of the audit process as well as the steps auditors must take to ensure a confirmation from a third party is reliable audit evidence.

Understanding some of the long-standing issues of the audit process and to ensure "reliable audit evidence," auditors have a duty to control the confirmation process—whether working within a paper, electronic, or hybrid process. Controlling the process means that auditors must ascertain where they are sending the confirmation: Where did it go? Is it a valid address? They must also determine if the third-party responder is authorized to respond on behalf of the client. With all this in mind, at the heart of the ideal confirmation process is the critical step of validation.

The importance of validation

To understand what auditors go through to "control the confirmation process," it's first important to understand the standards. Original SAS 67 was issued to guide auditors in identifying errors in the auditing process and sets the framework on how to send confirmations. SAS 67 dictates that auditors must:

- **Maintain control** of the process.
- **Maintain direct communication** to third-party responders who are knowledgeable and free from bias.
- **Maintain professional skepticism** throughout the process.

AU Section 330.15 as defined by PCAOB (Public Company Auditing Oversight Board) expounds on the auditor's responsibilities throughout the confirmation process, stating:

"The auditor should exercise an appropriate level of **professional skepticism** throughout the confirmation

process. Professional skepticism is important in designing the confirmation request, performing the confirmation procedures, and evaluating the results of the confirmation procedures.”

With an emphasis on controlling the audit process and professional skepticism, validation is clearly an important step within the audit confirmation workflow. Validating where confirmations are sent and authenticating individual responders allows auditors to better maintain a bias-free process, support audit opinions with reliable evidence, and reduce the risk of confirmation fraud.

Today's audit confirmation process

Investors, lenders, government agencies, and the public rely heavily on an external auditor's independent opinion from a financial audit on whether a company's financial statements are accurately presented. An easy way for a company to inflate its cash balance is to create phony invoices used in its general ledger or financial statements. With so much at stake, auditors are required to obtain “sufficient and appropriate audit evidence” to support their opinion:

- **“Sufficient”** relates to the quantity of audit evidence obtained. Has the auditor gathered enough?
- **“Appropriate”** relates to relevance and reliability. Has the auditor put forth appropriate effort to ensure the legitimacy of respondents?

To comply with these baseline items, auditors must follow the four key tenets of a proper audit confirmation:

1. Communicate directly with and receive an active response from the third party.
2. Exercise professional skepticism.
3. Identify and validate a respondent who is free from bias and authorized to respond.
4. Maintain control of the confirmation process.

Critical to the reliability of the process is Tenet 3: “Identify and validate.” A reliable audit confirmation process means the auditor has assurance that he or she is sending the confirmation request to the intended recipient. At the entity level, the auditor should determine that the confirming entity is a legitimate enterprise by validating information, including:

- Primary mailing address
- Physical address
- Website
- Telephone number



Today's audit confirmation process requires sufficient, appropriate evidence.

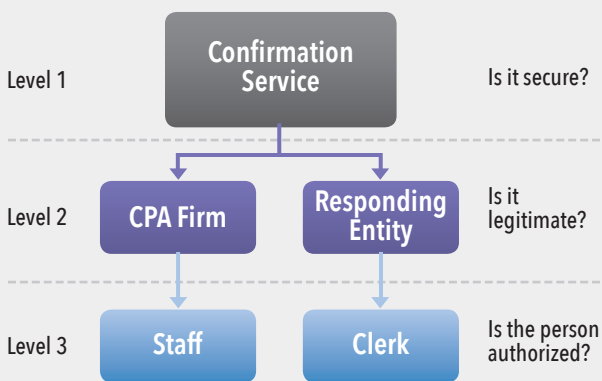
At the individual level, verification of the respondent's identity is required. The auditor must obtain assurance that the respondent is qualified and authorized to respond and has access to the necessary data.

At the private company level, it's important that the responding entity know who they are sending private information back to—that is, an actual accounting firm.

With so many standards in place to maintain the integrity of the audit confirmation process, auditors have a great deal of responsibility on their shoulders. Ensuring reliability requires attention to detail in building the confirmation process, specifically in relation to validating sources. The following diagram illustrates the relationship between the auditor and

the responder to an electronic confirmation request. It indicates that authentication, validation, and security are required at their respective levels.

With electronic confirmations as the norm today, auditors are seeing the benefits of a far more efficient process. They are also armed with powerful online confirmation tools to expedite validation in order to ensure reliability of audit evidence. With this in mind, the “ideal” audit confirmation process is obtainable.



The ideal audit confirmation process is streamlined and highly efficient.

The ideal audit confirmation process

Implementing the ideal audit confirmation is possible when auditors have the right technology in place. The ideal process supports validation capabilities, is powered by a highly secure confirmation service, and also includes an easy method for using paper confirmations when needed. While digital confirmations are the norm, to date, paper has not been eliminated from the process altogether. Even leading confirmation solutions do not house every responding entity, for example, every bank in existence. There will always be an instance where paper confirmations must be sent. The ideal confirmation process, then, should be supported by a solution that not only offers electronic validation within a highly secure platform, but also tools for validating and sending paper confirmations when needed.

Consider all the elements that make up the ideal confirmation process and the value of a streamlined, secure, and highly efficient workflow:

- 1. Ability to perform electronic confirmations.** Leading online confirmation solutions support a highly secure digital confirmation process. By communicating with respondents directly via an online platform, auditors save countless hours and can eliminate a great deal of manual, time-draining tasks.
- 2. Powerful validation functionality.** With so much demand on auditors to maintain control of the process and ensure reliability of information, they must be armed with a solution to authenticate both the responding entity and the individual respondents. The most helpful solutions are those with a comprehensive in-network base, where entities and individuals are vetted and entered as “authentic.” This feature ensures reliability of audit evidence, saves countless hours, and helps reduce fraud by validating respondents.
- 3. Support for paper-based confirmations.** While digital is preferred, there will likely be the need to send a few paper confirmations. Consider that not every bank can be registered in any one solution—there will always be outliers. As such, robust solutions will provide auditors with tools to streamline the paper confirmation process, such as convenient look-up of a contact’s mailing address. Supporting paper confirmations within an online confirmation solution further increases efficiency and streamlines the broad process.
- 4. The highest level of security.** The overall online audit process, despite all measures to obtain sufficient, appropriate evidence, isn’t worth much if it’s not secure. Confirmations contain highly sensitive and confidential data, such as the audit client’s bank account numbers, loan numbers, and bank balances. Therefore, the ideal process requires a platform that supports the highest level of security for all parties. It is imperative that the electronic confirmation process have controls in place that offer a secure communication channel between the auditor and all responders.

Both responders and auditors demand a high level of security from any electronic confirmation platform. Responders, such as banks, view the platform as an extension of their own internal system, so security is of the utmost importance. As such, leading online confirmation solutions secure such certifications as SOC, ISO 27001, and TRUSTe.



Final thoughts

The advent of online confirmation solutions has altered the audit landscape forever, offering a far more efficient and streamlined process and having armed auditors with the tools required to maintain control over the process with the ability to directly communicate with and validate responders. Today's leading online confirmation solutions offer auditors in-network capabilities to accomplish such key requirements as:

- Control the broad audit confirmation process.
- Maintain the integrity of data and data transmission.
- Authenticate entities (websites, addresses, etc.).
- Establish direct communication with entities and validate respondents.

Leading online technologies better prepare auditors to meet ever-changing audit standards, support professional skepticism, and ensure reliable audit evidence. Today, auditors can make the *ideal* audit confirmation process a reality.

CPA.com forms strategic alliances with leading solutions providers focused on the accounting profession and serves as a value-added distributor of these solutions to CPA firms nationwide. Confirmation.com is a preferred partner of CPA.com for its all-encompassing cloud-based audit confirmation solution.

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