Confirmation.com

The E-Sign Act

Use and Enforceability of Identifiers, Passwords and Personal Identification Numbers as Signatures

The E-Sign Act

Use and Enforceability of Identifiers, Passwords and Personal Identification Numbers as Signatures

Introduction

The following white paper discusses the legality and enforceability of the Confirmation.com™ service ("Confirmation.com") of Capital Confirmation Inc. in connection with obtaining third-party confirmations from financial institutions, law firms, broker dealers, insurance companies and other potential responders as part of audits or similar transactions.

The Audit Confirmation Process

As part of a typical audit, the auditors routinely require confirmation from third parties such as financial institutions as to the account balances, amount of indebtedness of the audit client, insurance policies in place, and legal matters. In the past, this process has been paper-based. That is, the auditor will send a letter to the responding party. The responding party will gather the information, prepare the confirmation, and deliver the confirmation response to the auditor. This process is both time consuming and expensive for the client, the auditor and the responding party.

The paper-based process also exposes the auditor and the responding party to substantial unwanted fraud liability. An overwhelming majority of auditors surveyed by Confirmation.com receive the responding party's address and contact information from the client or client documents such as a statement provided by the client. Auditors are thus exposed to fraud when given incorrect contact information either intentionally or unintentionally.

The definition of third-party confirmations requires responding parties to return confirmation requests to an address that is specifically not the client's address. Responding parties are at risk when client information is received by an unauthorized party either intentionally or unintentionally. This occurs when an unauthorized party mails a fraudulent request to the responding party using a false client signature as the client's signature. Because significant opportunities for fraud exist with paper-based confirmations, inherent in the paper process is a level of risk and related liability. That liability is significantly increased without a thorough and complete third-party authentication process of all contact information, mailing addresses and signatures.

Capital Confirmation has developed certain patented software and systems that allow for electronic audit confirmations using a secure third-party authentication process. Confirmation.com enters into agreements with the responding parties, audited businesses and accounting firms to allow access to the confirmation system developed. The system depends upon the use of unique identifiers, electronic signatures, passwords and identification numbers to permit access to and use of the system.

The Confirmation.com Service

The patented Confirmation.com service is a secure third-party authentication platform of information transfer between the third-party confirmer and the auditor. Confirmation.com allows an accountant - or auditor - to request confirmations related to a particular client and permits a responding company, as third-party confirmer, to respond to such requests. The process is principally electronic and ultimately requires authentication of each of (i) the accounting firm, (ii) the accountant/auditor and (iii) the client who is the subject of the audit. The process also requires two "signatures": an electronic authorization (in the form of the electronic signature process and user agreement acceptance) and a physical authorization (typically in the form of an audit firm engagement letter with the audit client). The authentications and signatures are important in establishing authorization and maintaining the security of the information transfer. The following is a description of some of the features of the Confirmation.com system that are designed to ensure authentication, authorization and secure transfer of information.

Confirmation.com has established a thorough, multi-step authentication process to authenticate each accounting firm, accountant/auditor and audit client involved in the Confirmation.com process. A validated and authenticated audit client user receives directly from the Confirmation.com system an email request asking them to approve – through the use of an electronic signature – the use of the Confirmation.com system by the responding party. The link in the email takes the client into the Confirmation.com system where the client electronically signs – either by digitally signing with their mouse, finger, stylus or other, or by typing their name – their approval for the auditor to request the confirmation through Confirmation.com and for the responding party to provide the confirmation response back to the auditor through Confirmation.com. The electronic signature approval generation process can only be initiated by the authenticated accountant through the use of a login to the Confirmation.com service using their unique ID and password. If a client user's email becomes invalid, the electronic signature approval will not reach such client and the Confirmation.com service would be halted. The Confirmation.com system is designed such that the audit firm cannot initiate a confirmation request through the Confirmation.com system without the client's electronic signature approval. The audit firm can only obtain the electronic signature approval from the audit client thus ensuring the audit client's authorization to request confirmation. The electronic authorization is such electronic signature. The use of the electronic signature by the authenticated audit client creates the authorization for the authenticated audit client's financial institution, insurance firm, law firm, broker dealer and other responders to release information regarding the audit client to the specified authenticated accountant/auditor via the Confirmation.com service. In addition, the audit firm and audit client each agrees and acknowledges that among other matters, that they each have authorization to request the confirmation information.

In addition to the electronic authorization, the highlights of which are discussed above, there is a physical authorization to the Confirmation.com process. An authenticated accountant/auditor user's authenticated accounting firm must receive proper written authorization from an authenticated client user in order to use the Confirmation.com service. This authorization is usually in the form of an engagement letter between the audit firm and the audit client. The written authorization is to be kept on file by the authenticated accounting firm for at least five years. The Confirmation.com process ultimately provides a means by which only a licensed accounting firm's accountant/auditor user can set up a client and only an authorized representative of the responding party's client can authorize an audit confirmation, creating a traceable path of accountability governed by applicable laws and regulations.

Critical to the process is the authentication of the responding party. Confirmation.com sets up secure links between the accountant/auditor and a validated responding party, assuring that when a confirmation request is sent, it goes directly to the responding party without interference. Further, because the process is fully automated, the requested information is transmitted to the auditor/accountant in a secure fashion. The use of encryption and digital signatures allows the auditor/accountant to have an extremely high degree of confidence in the integrity and authenticity of the confirmation information. Indeed, the confidence level is much higher than is present in the paper-based confirmation process because there are far fewer opportunities for errors or corruption of the process.

The E-Sign Act: The Use of Identifiers, Passwords and Personal Identification Numbers as Signatures

Confirmation.com contracts indicate that the participants in the system will rely upon the unique identifiers used by other participants. That is, when a party enters the system using the unique identifiers, other participants are entitled to rely on the fact that the identifiers are tied to the specific participant. Actions taken by persons using the unique identifiers are presumed to be actions of the person associated with those identifiers. In essence, a message sent with those identifiers is deemed to be signed by such person, and will be enforceable against such person to the same extent as if the message were contained in a paper document bearing a physical signature.

As a general matter, the parties to commercial arrangements such as created by Capital Confirmation are permitted to establish the framework for communications, the methods by which those communications may be transmitted, the manner in which those communications will be treated, and the legal effect of such ommunications. The parties may agree that messages or communications using the unique identifiers assigned to a party will be deemed to be communications of such party.

The ability to so contract has been strengthened by the Electronic Signatures in Global and National Commerce Act, signed by President Clinton in 2000 (15, U.S.C. 7001 et. Seq.). In that Act, commonly known as the E-Sign Act, Congress has specifically provided as follows:

> Notwithstanding any statute, regulation, or other rule of law (other than this subchapter and subchapter II of this chapter), with respect to any transaction in or affecting interstate or foreign commerce – (1) signature, contract, or other record relating to such transaction may not be denied legal effect, validity, or enforceability solely because it is in electronic form; and (2) a contract relating to such transaction may not be denied legal effect, validity, or enforceability solely because an electronic a signature or electronic record was used in its formation. 15 U.S.C. 7001(a).

While the E-Sign Act contains numerous provisions relating to transactions involving consumers, those limitations generally do not limit the ability or enforceability of signatures or records in electronic form among commercial entities.

The E-Sign Act allows states to enact statutes governing the use of electronic records and signatures, and many have done so. Several have adopted the Uniform Electronic Transaction Act (“UETA”), promulgated by the National Conference of Commissioners on Uniform State Laws. However, the adoption of state laws, whether they be versions of UETA or stand-alone statutes, cannot limit the basic thrust of the general provision of E-Sign giving effect to electronic signatures and records.

Important in this context is the definition of a signature. In general, a signature is a symbol adopted by a party to authenticate a writing. See Section 1-201(39) of the Uniform Commercial Code. E-Sign and UETA follow this approach. In general, a signature is “an electronic sound, symbol, or process, attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record.” 15 U.S.C. 7006(5). Examples of signatures could include such things as digital signatures, mouse clicks on an “I accept” button, biometric identifiers associated with a message, or PINs and passwords. Also important is the concept of record retention. E-Sign generally requires that records be retained and be capable of reproduction. 15 U.S.C. 7001(d)(2).

Confirmation.com contracts include such specific provisions governing the use of identifiers, as well as the security and encryption procedures to be utilized, and the legal effect of the transmission of messages and requests containing the identifiers. A court of law should therefore give effect to the contractual provisions stated and agreed to in such contracts. It is noted that both E-Sign and UETA require that the parties consent to the use of electronic signatures and records, and that one party cannot unilaterally require another to do so. Accordingly, the need for specificity in the contract is of paramount importance, and is incorporated in the Confirmation.com contracts to satisfy this requirement. For convenience, Attachment One is a copy of the relevant provisions of the E-Sign Act.

ATTACHMENT ONE:
Relevant E-Sign Act Provisions

15 USC Sec. 7001. – General rule of validity

(a) In general

Notwithstanding any statute, regulation, or other rule of law (other than this subchapter and subchapter II of this chapter), with respect to any transaction in or affecting interstate or foreign commerce -

> **1)** a signature, contract, or other record relating to such transaction may not be denied legal effect, validity, or enforceability solely because it is in electronic form; and
>
> **2)** a contract relating to such transaction may not be denied legal effect, validity, or enforceability solely because an electronic signature or electronic record was used in its formation.

15 USC Sec. 7006. – Definitions

(5) Electronic signature

The term "electronic signature" means an electronic sound, symbol, or process, attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record.

For more information, contact us at 1-888-716-3577 or visit www.confirmation.com.

Endnotes

[1] Authentication by Confirmation.com includes such steps as independent third-party validations, periodic reviews, identity certifications and valid email verifications. This memorandum does not delve into the specifics of the authentication process, which is quite extensive and involved. Where an accounting firm, auditor/accountant or client cannot be verified and authenticated, such party will not and cannot be involved in the Confirmation.com process.

[2] Authentication by Confirmation.com includes such steps as physical validation, independent third-party validations, periodic reviews and identity certifications. This memorandum does not delve into the specifics of the authentication process, which is quite extensive and involved. Where a responding party cannot be verified and authenticated, such party will not and cannot be involved in the Confirmation.com process.