

SPOTLIGHT

Observations and Reminders on the Use of a Service Provider in the Confirmation Process

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OVERVIEW

The Public Company Accounting Oversight Board (PCAOB) is committed to driving improvement in audit quality and promoting compliance with our professional standards and rules. To accomplish these objectives, we not only focus on detecting audit deficiencies, but also on communicating observations and other information that could impact the quality of audits of public companies and brokers and dealers.

Many audit firms use a service provider to send and receive electronic audit confirmations to and from third parties, such as financial institutions, investment and brokerage firms, and law firms (“confirming party”) to independently verify or validate balances, terms of arrangements, or other information under audit. These audit firms rely on the service provider, including its related processes and technologies, to initiate the third-party request, establish a direct communication with the confirming party, and ultimately obtain the information from the confirming party. The PCAOB understands that the use of such service providers is becoming more common, partially due to certain confirming parties only replying to auditor confirmation requests through a specific service provider.

The use of audit confirmations is a procedure to obtain reliable external evidence of an audit client’s internally generated information. The requirement to maintain control over the confirmation process is important to ensure confirmation responses are reliable. Audit firms that use a service provider to send and receive confirmations rely on the service provider’s assistance in maintaining control over the confirmation requests and responses. These service providers use their own processes and controls in communicating the auditor’s confirmation request to, and obtaining responses from, the confirming

What Is the Confirmation Process?

Under PCAOB standards, the auditor is required to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion. In many audits, obtaining evidence involves, among other things, requesting that a confirming party (e.g., a financial institution) confirm amounts recorded in the public company’s or broker-dealer’s financial records.

Confirmation, **as defined under PCAOB standards**, is the process of obtaining and evaluating a direct communication from a third party in response to a request for information about a particular item affecting financial statement assertions. The process includes:

- Selecting items for which confirmations are to be requested;
- Designing the confirmation request;
- Communicating the confirmation request to the appropriate third party;
- Obtaining the response from the third party; and
- Evaluating the information, or lack thereof, provided by the third party about the audit objectives, including the reliability of that information.

party. Therefore, it is necessary for auditors to determine that they can rely on the service provider’s processes and controls when establishing direct communication between the auditor and the confirming party.

Recently, we observed diverse practices related to the procedures auditors perform to support

such reliance. In some cases, audit firms were not giving any consideration to support whether, as required by PCAOB standards, the auditor maintains control over the confirmation requests and responses in audits where a service provider is used to send and receive confirmations.

The information in this Spotlight is not staff guidance; rather, it provides observations and suggested procedures for auditors who may find this information valuable as they plan and perform audits.

MAINTAINING CONTROL OVER THE CONFIRMATION REQUESTS AND RESPONSES

PCAOB auditing standard AS 2310, *The Confirmation Process*, requires that the auditor maintain control over the confirmation requests and responses during the performance of confirmation procedures. Maintaining control means establishing direct communication between the intended recipient and the auditor to minimize the possibility that the results will be biased because of interception and alteration of the confirmation requests or responses. Although the standard does not specifically address using a service provider for establishing direct communication, the requirement in the standard still applies when such service provider assists an audit firm in maintaining control over confirmation requests and responses.

PCAOB quality control standard, QC Section 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, requires an audit firm to have a quality control (QC)



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system that provides the audit firm with reasonable assurance that the work performed by its audit engagement personnel complies with professional standards, which includes maintaining control over confirmation requests and responses.

How an auditor maintains control over the confirmation requests and responses depends on how they intend to communicate confirmations to the confirming party. For example, in some cases, when auditors use a service provider as part of the confirmation process, they rely on the service provider's technology to initiate the request and establish a direct communication between the auditor and the confirming party.

As noted earlier, auditors use service providers in the confirmation process to send and receive confirmations electronically. The service provider's technology is intended to create a secure confirmation environment that may mitigate the risks of interception or alteration. We expect auditors to support that

they maintained control over the confirmation requests and responses in audits where a service provider assisted in the confirmation process. Simply, the use of a service provider does not relieve the auditor of the responsibility under PCAOB standards to maintain control over the confirmation requests and responses.

PCAOB STAFF OBSERVATIONS

When auditors use a service provider to send and receive confirmations, we observed that the procedures performed by audit firms to support that the auditor maintained control over the confirmation requests and responses vary depending on a number of factors including the size of the audit firm, engagement-specific facts and circumstances, and the extent to which the provider is used. Many of these procedures are performed at the audit firm level, rather than by individual engagement teams.

We also observed that some audit firms use an Independent Service Auditor's Report on Service Organization Controls ("SOC reports") in evaluating the design and operating effectiveness of the service provider's controls related to sending and receiving confirmations. As an alternative to obtaining SOC reports, audit firms may perform direct testing of the design and operating effectiveness of the service provider's controls.

The following are examples of situations we observed in which audit firms did not perform, or sufficiently perform, procedures to support their use of a service provider to send and receive confirmations:

Performing insufficient evaluation of SOC reports – The audit firm obtained SOC reports but did not:

- Perform a timely review;

- Evaluate the results of the procedures performed by the service auditor;
- Consider the design and operating effectiveness of controls not addressed by the SOC reports; or
- Assess whether additional testing procedures, such as compensating controls, were necessary.

Consideration of the period covered – The audit firm reviewed the SOC reports but did not consider the time that elapsed since the period covered by the SOC reports, and when the audit firm used the service provider to send and receive confirmations.

Lacking consideration of other controls – The audit firm did not consider complementary user entity controls delineated in the SOC reports.

Insufficiently coordinating procedures performed – Some audit firms performed limited QC procedures centrally and relied on engagement teams to evaluate SOC reports or perform direct testing of the design and operating effectiveness of the service provider's controls. There was a lack of coordination between procedures performed centrally by the audit firm and those performed by the engagement team.

CONSIDERATIONS

Maintaining control over confirmation requests and responses is an important area that the PCAOB may focus on in upcoming inspections.

We encourage audit firms to ensure their QC systems are appropriately designed and operate effectively so that policies and procedures related to the use of a service provider to send and receive confirmations provide reasonable assurance that engagement teams comply with professional

standards as it pertains to maintaining control over confirmation requests and responses.

We highlight below examples of procedures an audit firm may perform to support – in accordance with professional standards – the use of a service provider to maintain control over the confirmation requests and responses when such service provider sends and receives confirmations. Audit firms should give consideration as to how these examples may apply to their audit engagements and whether they need to implement changes to their current policies and procedures.

- **Assessing the design and operating effectiveness of a service provider’s processes and controls** – This assessment can happen through either obtaining and evaluating SOC reports or performing other procedures that support the use of a service provider to maintain control over the confirmation requests and responses in order to ensure the reliability of audit evidence obtained.
- **Reviewing and timely evaluating SOC reports to consider factors that may affect the risk of misstatement** – Obtain sufficient understanding of the procedures performed in the SOC reports and consider any factors that may affect the engagement team’s execution of the audit plan. Design any additional procedures that may be necessary to perform.
- **Inquiring about changes in the controls that may have occurred at the service provider for the time that elapsed since the period covered by the SOC reports** – If significant changes occurred during the elapsed period (period not covered by the SOC reports), consider if obtaining an updated SOC report or performing other procedures are required.



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- **Performing an evaluation of complementary user entity controls** – For example, audit firms may perform procedures to identify any necessary user controls that should be implemented at the user organization.
- **Engaging in periodic communications with the service provider** – Such communications can be used to (1) determine the effect of changes, if any, in the service provider’s control environment on the audit firm’s engagements and (2) identify operational issues (e.g., cyberattacks and system delays) that may affect the integrity of confirmations returned to auditors through the service provider’s technology tools.

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