Open Banking in Audit: Bank Confirmations

Mark Edmondson FCA
CEO, Inflo

inflosoftware.com

Advancing audit technology

Technological evolution is relentless across the world of business. Keeping pace with that change means auditors and accountants are evolving working practices to maintain the relevance of their work.

Administrative audit tasks such as trial balance tie-in or lead schedule creation are now automated. Audit sampling is being replaced by Audit Data Analytics to address the highly transactional nature of modern, global business.

Are bank confirmations – one of the staples of a junior auditor's career – the next in line to be modernized by technology?

What is a bank confirmation?

Bank confirmations fall within the broader category of external confirmations, which are defined by auditing standards as:

"Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium."

Bank confirmations represent a positive confirmation, meaning a request for confirmation as to whether the third party agrees or disagrees with the information provided, or to provide the requested information.

Consolidated vs account-based

There are two types of bank confirmation:

Consolidated

This is where the auditor requests the balance at a determined date for all financial relationships a bank holds with a named entity. Typically, the auditor provides account details for 1 known account, and the bank confirms all facilities the entity holds with them.

Account-based

This is where the auditor requests the balance at a determined date for a defined list of accounts, which they understand the entity holds.

Consolidated confirmations have the advantage of potentially providing auditors with additional audit evidence over unknown financial facilities, and thus verifying the completeness of accounts and loans the entity holds. Facilities undisclosed to the auditor, whether through fraud or error, could be included in a consolidated confirmation.

Account-based confirmations only provide evidence over facilities the entity has disclosed to the auditor. Facilities undisclosed to the auditor, whether through fraud or error, would not be included in an accounts-based confirmation.

The type of confirmation provided by banks varies from territory to territory, with account-based confirmations more common in the US and consolidated confirmations more common in Europe for example.

Caution is needed with consolidated confirmations and their completeness. Commonly, audit tests designed and intended to obtain a consolidated confirmation include qualifying statements from the confirming party. For example, that the bank have not performed a comprehensive, detailed search of their records and that the confirmation they provide does not relieve the auditor from their other duties. Such statements impact the reliance auditors can place on such a confirmation including all of the entity's banking arrangements.

Obtaining a bank confirmation

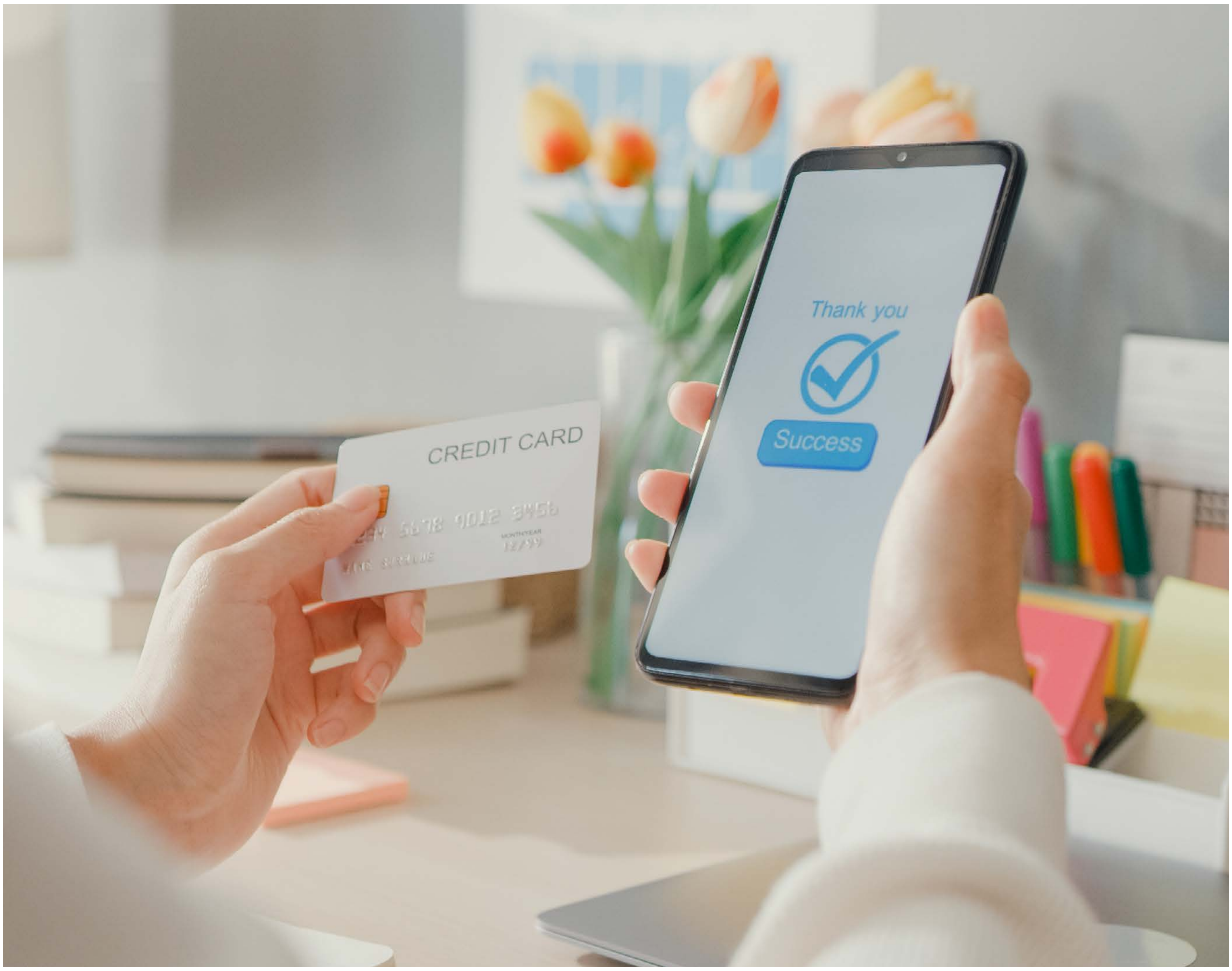
There are two traditional approaches to obtaining bank confirmations:

The auditor writes directly to the bank, via letter or email.

The auditor leverages a platform to communicate with the bank.

These approaches were necessary as the only way for an auditor to gain access to the confidential banking information of their client - provided the client granted their bank the authority to disclose this financial information to their auditors.

But the advent of Open Banking is changing some of the fundamental characteristics which dictated this approach. Open Banking means banks are more readily sharing not just balance information, but transactional data regarding their clients. And this simplifies the process for organizations to authorize access to their advisors or third-party applications.



The bank confirmation process

Manual Letter / Email	Platform	Open Banking
1. Auditor obtains a list of bank accounts from the client. 2. Auditor drafts confirmation and authority letters/emails. 3. Client signs and returns letters/emails to auditor. 4. Auditor sends letters/ emails to banks. 5. Auditor chases bank letters/emails. 6. Bank sends letters/emails. 7. Auditor compares bank letter/email to bank reconciliation.	1. Auditor adds client details to platform. 2. Auditor selects the bank. 3. Auditor adds account details to be confirmed with that bank. 4. Auditor sends authorization to client for approval. 5. Client provides authorisation. 6. Auditor initiates confirmation request. 7. Bank sends response via platform. 8. Auditor compares bank confirmation to bank reconciliation.	1. Auditor requests client connects to their banks. 2. Client selects bank and is shown accounts held with that bank. 3. Client authorizes sharing of bank data. 4. Auditor compares bank confirmation to bank reconciliation.
Typical response time: **14 days** Typical auditor time: **2 hours per bank**	Typical response time: **7 days** Typical auditor time: **45 mins per bank**	Typical response time: **Instant** Typical auditor time: **10 mins for all banks**

The Open Banking process is highly streamlined compared to manual letters, emails, or confirmation platforms. It also places a much lower burden on the auditor, given the client authorization is embedded into the process and the banking information is available instantaneously.

More significantly there is a considerable increase in the quality of the information received. The risk of human error across the process is significantly reduced, such as a client error in the listing of bank accounts, the auditor not defining the client's name or account details 100% correctly, or the bank making a keying error or confirming balances at the incorrect date.

Via Open Banking the auditor receives the current balance and all transactions within the prior 2 years, in effect confirming the balance held at any date during that period.

Is Open Banking an external confirmation?

External confirmations are “obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium”. This includes the auditor’s direct access to information held by a third party.

Open Banking represents the provision of evidence from the bank to the auditor. The auditor can maintain control over the confirmation process and meet the additional external confirmation criteria. Therefore, Open Banking provides an external confirmation.

Further consideration of the external confirmation requirements per the auditing standards, and how Open Banking software meets these requirements, are included in appendix 1.

Is Open Banking a consolidated or account-based confirmation?

Open Banking offers a hybrid between an account-based confirmation and a consolidated confirmation.

When the client connects with their bank they are presented with all accounts, credit cards, loans, mortgages, and other facilities they hold with the bank, which the bank shares via Open Banking (see appendix 2 for the full list of facilities Open Banking can potentially include). In effect, the client is shown a consolidated confirmation when they connect to their banking provider. In effect, and depending upon how the bank has implemented Open Banking, the client is shown a consolidated confirmation when they connect to their banking provider.

The fact the client controls the authorization at an account-level is a fundamental design feature of Open Banking. A risk exists that the client could not select certain facilities to share, or the bank does not expose all bank facilities via Open Banking, meaning the auditor would not see all facilities. In this scenario, the auditor would be receiving an accounts-based confirmation.

Management representations stating all banking relationships available via Open Banking have been shared or alternative procedures to observe or reperform the connection process could be utilized by the auditor where this risk is deemed to exist. Could address some of this risk. A prudent approach would be to treat an Open Banking confirmation comparably to a consolidated confirmation with qualifying statements regarding completeness. That it is an account-based confirmation providing some evidence over completeness.

Prudently, Open Banking provides an account-based confirmation with some completeness evidence, comparable to a consolidated confirmation with qualifying statements.

Taking a risk-based approach

As with any audit procedure, it is important to consider the risk the auditor is attempting to address through their testing.

Sending external bank confirmations provides evidence relevant to multiple potential risks across predominantly two areas of the financial statements – bank balance assets and loan facility liabilities.

Detailed audit risks relevant to these two financial statement areas are included in Appendix 3.

1. Normal risks

Open Banking confirmations provide appropriate audit evidence over normal risks such as bank or loan balances not existing, being omitted, or not being owned or owed.

2. Fraud risks

Open Banking confirmations address the risk that bank or loan balances do not exist due to fraud. But in some audits, there may be a risk that the client deliberately and fraudulently conceals accounts they hold.

Where such a fraud risk is deemed to exist relating to the omission of bank or loan balances additional audit procedures are required as well as, or instead of, Open Banking confirmations.

Taking a risk-based approach

Fraud - known banking providers

Where the fraud is deemed to relate to the omission of bank of loan balances with known banking providers, auditors could for example obtain management representations over the completeness of the Open Banking confirmation authorisation or observe the client performing or reperforming the Open Banking authorisation – with the same finance contact as the original submission, or with a different finance contact. The auditor could alternatively submit a traditional consolidated confirmation to the banking provider in question.

Fraud - unknown banking providers

Where the fraud is deemed to relate to the omission of bank or loan balances with unknown banking providers, auditors face a greater challenge collecting appropriate audit evidence. Open Banking may offer a solution via the transactional data made available – for example through the review of large round sum deposits in trading accounts indicating the draw-down of a new loan facility. Round sum or recurring payments could also indicate movement of funds to undisclosed accounts. A detailed board minutes review may also be valuable to identify the approval of new banking providers.

It is worth noting, a client may refuse to authorise the sharing of data via Open Banking with their auditor. Auditors should carefully consider the reasoning for this, and whether in-itself this is a potential indicator of a heightened fraud risk.

Additional procedures

This risk-based approach highlights external confirmations obtained via Open Banking provide appropriate audit evidence over normal risks, and that potential risks of fraud can be addressed through additional audit procedures complementing the Open Banking confirmation process. While traditional consolidated bank confirmations via letter, email or confirmation platform offer alternative procedures, they rarely fully address the fraud risk, meaning more effective audit procedures may be available.

Firm policy

Modernizing a firm's bank confirmation process to leverage the Open Banking opportunity is best achieved through a clear firm-wide policy. A simple, illustrative example policy could be presented as follows:

Bank confirmations to be obtained on all audit engagements.

Confirmations expected to be obtained via Open Banking.

Confirmations obtained via Open Banking provide sufficient appropriate audit evidence over normal level risks.

Where fraud risks exist over bank account assets or loan facility liabilities, additional or alternative procedures are required regarding the Open Banking confirmation process or leveraging the transactional bank data obtained via Open Banking.

Deviation from the policy must be justified and/or approval from the firm's audit technical lead obtained.

Traditional bank confirmations via letter, email or confirmation platform are only to be obtained as an alternative procedure where:

- The client refuses to provide Open Banking authorisation, or
- To obtain additional evidence where Open Banking confirmation and complementing procedures are not deemed sufficient, and a traditional confirmation will provide new evidence.

New confirmations policies are heavily influenced by current policies. Firms with established operational processes or a reluctance to quickly move away from traditional confirmations may choose to maintain traditional approaches alongside the use of Open Banking to support balance confirmation and the use of transactional bank data.

Moving from balances to transactions

But perhaps the biggest opportunity Open Banking presents is the transition from simply confirming point-in-time balances to having access to 100% of banking transactions, through transactional data sets. This allows auditors to confirm the balance on each account at year end, and at any other time, as well as performing Audit Data Analytics over all bank transactions in year and post year end.

The ability to trace general ledger data sets to banking data sets obtained directly from third-party sources offers the potential to transform the audit process. Auditors can advance their automation of the audit of financial transactions settled during the period and focus their effort on unsettled transactions and management judgements, which typically represent a greater risk of material misstatement..

In conclusion

Open Banking provides auditors with a new, streamlined approach to obtaining external confirmation of the bank accounts and loan facilities held by an entity. The process is quicker, involves fewer steps, and reduces risk of human error.

Open Banking confirmations provide a comparable quality of evidence to traditional confirmations obtained via letter, email, or confirmation platform.

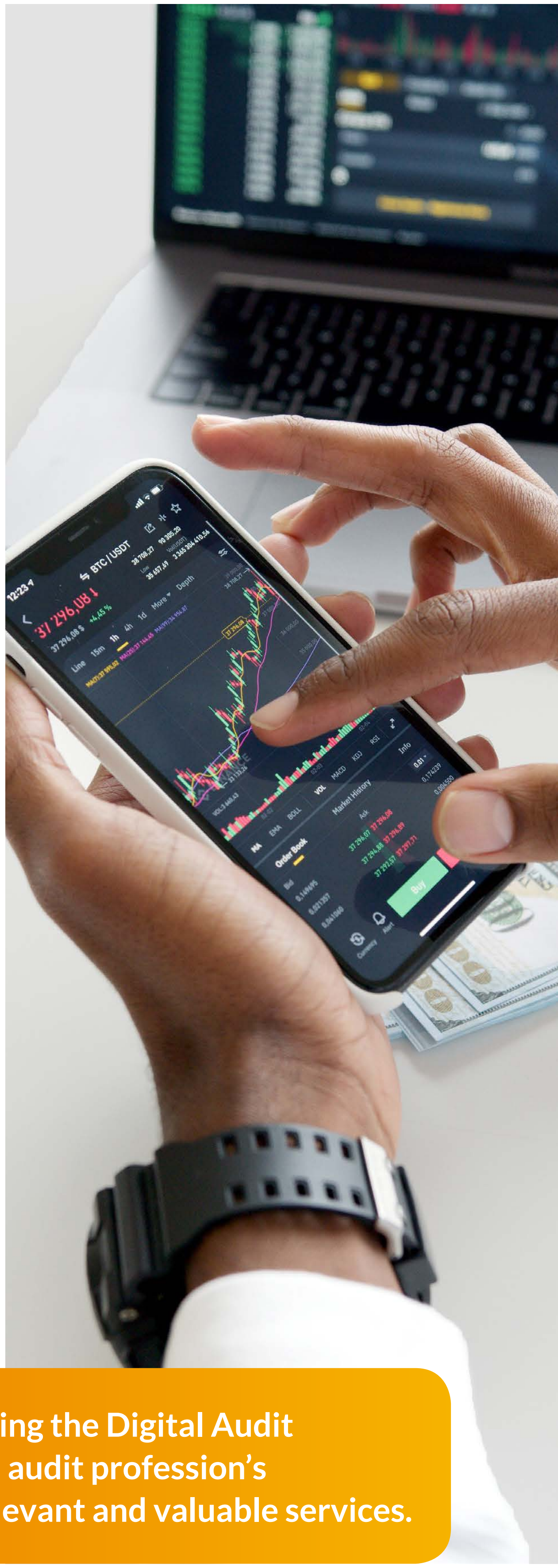
While providing some evidence over completeness, for prudence Open Banking confirmations should be considered an account-based confirmation. This is comparable to a consolidated confirmation containing qualifying statements regarding completeness.

Auditors must perform risk assessment in a more granular way to be specific about the potential risks of misstatement in bank balances and loan facilities. In their response to risk, auditors should critically evaluate the evidence external confirmations provide against these granular risks.

Open Banking confirmations, comparable to their more traditional counterparts, will require complementary audit procedures to fully address any fraud risk identified.

Firms can support effective change management in this common audit area through implementing clear policies regarding the use of Open Banking confirmations. The policy should also include the circumstances where a traditional confirmation will continue to be requested.

But embracing Open Banking to modernise the bank confirmation process more critically unlocks the ability to utilise bank transactional data more broadly across in the audit process. Powerful Audit Data Analytics can automate the audit of routine settled transactions and allow auditors to focus on higher risk areas, such as unsettled transactions and management judgements.



The increasing availability of reliable data is driving the Digital Audit movement. Open Banking is the next step on the audit profession's digitalization journey, evolving towards more relevant and valuable services.

Appendix 1

ISA 505

7. When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:

a. Determining the information to be confirmed or requested;

b. Selecting the appropriate confirming party;

c. Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor and

d. Sending the requests, including follow-up requests when applicable, to the confirming party.

AU-C 505

07 When using external confirmation procedures, the auditor should maintain control over external confirmation requests, including

a. determining the information to be confirmed or requested;

b. selecting the appropriate confirming party;

c. designing the confirmation requests, including determining that requests are properly directed to the appropriate confirming party and provide for being responded to directly to the auditor;

d. sending the requests, including follow-up requests, when applicable, to the confirming party.

Auditors retain control over the external confirmation process using Inflo Treasury as follows:

a. Auditors determine the information to be confirmed, stipulating to clients whether they want to confirm all accounts and information available via Open Banking for all banks the entity holds relationships with, or a subset.

b. Using Inflo Treasury and Open Banking, the auditor selects the appropriate confirming party they believe is knowledgeable about the information to be confirmed. Open Banking makes available to Inflo Treasury all transactions and facilities relevant to the entity.

c. Inflo Treasury Open Banking requests are consistently designed as a query for all information the client has approved Open Banking access to the auditor. The addressing of confirmation requests is incorporated into the Open Banking authentication process, as is the virtual return address – to Inflo Treasury - for the auditor to review the results. The confirmation request Inflo Treasury conducts is designed as a blank positive confirmation – i.e. a request for bank account information where the account details are provided but not the account balances.

d. The auditor, via Inflo Treasury, sends the Open Banking request to the confirming party. There is no need for follow-up requests as the response is immediate.

Appendix 2

Facilities included in Open Banking:

- 401a,
- 401k,
- 403B,
- 457b,
- 529,
- brokerage,
- cash isa,
- education savings account,
- ebt,
- fixed annuity,
- gic,
- health reimbursement arrangement,
- hsa,
- isa,
- ira,
- lif,
- life insurance,
- lira,
- lrif,
- lrsp,
- non-taxable brokerage account,
- other,
- other insurance,
- other annuity,
- prif,
- rdsp,
- resp,
- rlif,
- rrif,
- pension,
- profit sharing plan,
- retirement,
- roth,
- roth 401k,
- rrsp,
- sep ira,
- simple ira,
- sipp,
- stock plan,
- thrift savings plan,
- tfsa,
- trust,
- ugma,
- utma,
- variable annuity,
- credit card,
- paypal,
- cd,
- checking,
- savings,
- money market,
- prepaid,
- auto,
- business,
- commercial,
- construction,
- consumer,
- home equity,
- loan,
- mortgage,
- overdraft,
- line of credit,
- student,
- cash management,
- keogh,
- mutual fund,
- recurring,
- rewards,
- safe deposit,
- sarsep,
- payroll.

Appendix 3

Risk	Typical risk level	Assertions: Completeness	Assertions: Existence	Assertions: Rights & Obligations	Assertions: Valuation	Open Banking confirmation addresses risk?	Alternative / additional procedures
Cash at bank							
Bank balances may not exist	Normal		Yes			Yes	
All bank balances have not been recorded	Normal	Yes				Yes	Review prior year bank accounts for omission. Review board minutes for approval of new banking providers.
Entity does not hold or control the rights to bank balances	Normal			Yes		Yes	
Bank balances have not been recorded appropriately	Normal				Yes	Partly	Retranslation of foreign currency balances
Fraud: Bank balances may not exist	Significant		Yes			Yes	
Fraud: All bank balances have not been recorded with known banking providers	Significant	Yes				Partly	Management representations regarding the completeness of the Open Banking information provided Observe client contact performing Open Banking confirmation Request a traditional consolidated confirmation from the bank
Fraud: All bank balances have not been recorded with unknown banking providers	Significant	Yes				Partly	Review Open Banking transactional data for unusual withdrawals - round sum, repetitive etc. Review board minutes for approval of new banking providers.
Loans and obligations							
Loan balances may not exist	Normal		Yes			Yes	
All loan balances have not been recorded	Normal	Yes				Yes	Review prior year loan facilities for omission. Review board minutes for approval of new banking providers.
Entity does not owe or is not liable for loan balances	Normal			Yes		Yes	
Loan balances have not been recorded appropriately	Normal				Yes	Partly	Retranslation of foreign currency balances
Loan balance covenants have not been complied with	Normal			Yes		No	Review of convenient reporting and other communication to the bank Review of loan agreements
Fraud: Loan balances may not exist	Significant		Yes			Yes	
Fraud: All loan balances have not been recorded with known banking providers	Significant	Yes				Partly	Management representations regarding the completeness of the Open Banking information provided Observe client contact performing Open Banking confirmation Request a traditional consolidated confirmation from the bank
Fraud: All loan balances have not been recorded with unknown banking providers	Significant	Yes				Partly	Review Open Banking transactional data for large, round sum deposits. Review board minutes for approval of new banking providers.

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