Accounts Payable Audit Confirmations

Why Companies Should Control Their Responses
Presented By

Brian Fox – CPA, Founder and Chief Marketing Officer of Confirmation.com
April 5, 2011

Dear Sir or Madam:

Our auditors, Houser CPA Group, are auditing our financial statements and wish to obtain direct confirmation of amounts owed to us as of 12/31/2010. Complete the information below with your records on that date and confirm that the information agrees with your records or note the details of any discrepancies in the space provided below. Then please sign this request and return it in the enclosed reply envelope directly to our auditors.

Our records on 12/31/2010 showed invoice 99437662 totaling USD * 849,665.00 as receivable from you. Please note that this invoice may not represent the entire balance owed to us as of that date. This is not a request for payment and a retention is not to be sent to Houser CPA Group.

Your prompt attention to this request will be appreciated.

Sincerely,

Walt Yerger
Lancaster Title Company

(Please do not detach)

CONFIRMATION

The information as stipulated above by Lancaster Title Company is correct except as noted below:

________________________________________________________________________

________________________________________________________________________

________________________________________________________________________

________________________________________________________________________

________________________________________________________________________

Signed: _______________________ Date:____________________ 

Title: _______________________ Customer #:24124

Company: ___________________

Thomas Industries
3338 Powell Street
Columbus OH 63002
Things to Consider
About the Current Paper Confirmation Process

1. Who has access to confirmation information in the response?
2. Is the requestor really an auditor?
3. Who receives the confirmation?
Things to Consider

About the Current Paper Confirmation Process

4. Who is completing the response?
5. Did the vendor really sign the confirmation?
6. Who validated the return address on the confirmation?
If not processed properly – it can create unnecessary risk and liability for your company.
How?
Col-lu-sion

noun

Secret agreement or cooperation, especially for an illegal or deceitful purpose.

Source: Merriam-Webster
Does this executive look like he would ever be involved in collusion?
Collusion involving AP Audit Confirmations

When a sales or relationship manager colludes with a vendor and sends false information to the vendor’s auditors.
Let's take a closer look
Vice President of Sales – Major Accounts

Manages sales for the company’s 10 largest accounts

These 10 accounts bring in 65% of company revenues
Lack of an Audit Confirmation Response Process

Makes it easy for sales and relationship managers to respond falsely to these requests.
Companies That Have Been Involved In Confirmation Fraud
Why your company should care
SEC has used enforcement actions against third-parties when there’s been evidence that confirmations were bogus.

Even if you’re a non-public company, the SEC believes it should be able to rely on confirmations without concern.
Good Intentions Don’t Count

Flawed efforts to control responses may result in charges against a company.

Negligence standard may apply to customers, vendors and creditors of a public company.

SEC may bring cases against third parties for providing misleading confirmations to another company’s auditors.
Control Responses to Protect Your Company

- Run all responses to audit confirmation requests through the accounting department rather than sales or marketing.

- Establish policies on how to review and respond to requests for confirmations from auditors of other entities.
Audit Confirmation Standards

Original SAS No. 67

1991
Original SAS No. 67

The Confirmation Process

1. Auditor must **Maintain Control**
2. Direct communication with the third-party
3. Professional skepticism
4. Respondent is knowledgeable and free from bias
5. To validate faxed confirmations:
   - Verify the source and contents of a facsimile response in a telephone call to the purported sender.
   - Request the purported sender to **mail the original** confirmation directly to the auditor.
Original SAS No. 67

1991  2003

Practice Alert 2003-1
Practice Alert 2003-1
Confirmations

What Changed?
Practice Alert 2003-1

Confirmations

1. Maintain Control
2. Direct communication through an active response
3. Discouraged alternative procedures
4. Using client’s online banking capability is not an audit confirmation
5. To validate fax and email confirmations:
   - Verify by telephone with the purported sender the source and contents of a response received by fax or email.
   - Ask the sender to mail the original confirmation directly to the auditor.
Audit Confirmation Standards

Original SAS No. 67

1991

Practice Alert 2003-1

2003

Updated Standards

2010
New Standards: ASB, IAASB, PCAOB*

1 Definition of External Confirmation

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

* PCAOB proposed standard is awaiting final publication.
New Standards: ASB, IAASB, PCAOB*

To Ensure Reliability of the Electronic Confirmation

Auditor may address such risks:

• Using a system or process that validates the respondent.

• Directly contacting the purported sender to validate the identity of the sender and validate the information received by the auditor corresponds to what was sent by the sender.

* PCAOB proposed standard is awaiting final publication.
Additional PCAOB* Item

Expands Receivables Requirement

Expands the requirement of confirmation procedures to receivables that arise from credit sales, loans, or other transactions.

* PCAOB proposed standard is awaiting final publication.
Do Not Respond Policies

Don’t Work!
Do Not Respond Policies Don’t Work

- Only keeps the legitimate responses from going out
- Does not address fraudulent responses
- Employees have the opportunity to continue responding on behalf of your company
- Exposes your company to legal liability and unwanted press
Types of Confirmation Fraud Schemes
Confirmation Fraud Schemes

- Client provides false information
- Client provides the contact name
- Client influences the confirmation process
- Signature verification is impracticable
Where Does Fraud Occur?

- 68% Non-Public Companies
- 32% Public Companies

Source: ACFE 2010 Report
Confirmation Fraud Examples

**Kmart Fraud**
Eastman Kodak – Vice President (Sales)
Coca Cola – National Director of Sales
Pepsi-Cola – National Sales Director
Frito-Lay – Director of Sales
Frito-Lay – National Account Manager

**Just For Feet Fraud**
Adidas – Director of Apparel Sales
Fila – President & CEO
Converse – Vice President of U.S. Sales

**Ahold Fraud**
Sara Lee Foods – Sales Manager
Con Agra Foods – Account Manager
Sara Lee Bakery Group – Sales Manager
Sugar Foods – Vice President of Sales
Koch Poultry – Owner
Heritage Bag – CEO
Citrus World – Account Manager
SEC vs. Adidas

Vendor: Just for Feet
Responder: Timothy R. McCool, Director of Sales Apparel for Adidas America
Plead: Guilty

- McCool an audit confirmation letter, requesting that McCool, on behalf of Adidas, confirm to Deloitte & Touche that Adidas actually owed JFF $2.2 million for advertising that ran or merchandise sold prior to January 30, 1999.

- McCool, knowing that the information contained in the audit confirmation letter was false, signed it and sent it to Deloitte & Touche.
Confirmation Fraud Examples

SEC vs. North Face

Vendor: The North Face
Responders: Two Customers

- Todd Katz, Vice President of Sales and Richard Tyrer, Vice President of Western Region Sales persuaded a customer of the company to lie to the internal investigators and senior management, and to sign false documents, knowing that the information would be relied upon by the auditors.

- SEC noted in its settlement.

- Tyrer and Katz persuaded a second customer to sign a false confirmation letter, which also was relied upon by the auditors.
SEC vs. Eastman Kodak

Vendor: Kmart
Responder: Darrell Edquist, Eastman Kodak Vice President – Kmart Account

Circumstances:
1) Wal-Mart recently signed a long-term contract with Fuji, Kodak’s archrival. Therefore, maintaining good relations with Kmart was top priority.
2) Kmart threaten to sell exclusive rights to Fuji for end of aisle displays.
3) Edquist was newly in charge of the Kmart relationship.

Action: Signed a false $7million confirmation
SEC vs. Eastman Kodak

Vendor representatives participated in:
False or misleading third party confirmations to Kmart's independent auditor, PricewaterhouseCoopers LLP.

As a result, Kmart's net income for the fourth quarter and fiscal year ended January 31, 2001, was overstated by approximately $24 million or 10 percent, as originally reported. The company restated its financial statements after filing for bankruptcy to correct these and other accounting errors.
Confirmation Fraud Examples

SEC vs. Coca-Cola

Vendor: Kmart
Responder: David C. Kirkpatrick, Coca Cola National Director of Sales – Kmart Account

Circumstances:
1) Kmart contacted Kirkpatrick and asked for a favor.
2) Kmart offered additional sales and promotional activities in return.
3) Kmart agreed to sell targeted amounts of Coke throughout the year

Action: Signed a false third-party confirmation letter pulling forward $3 million worth of allowances.
SEC vs. Pepsi-Cola

Vendor: Kmart
Responder: David M. Bixler, Pepsi-Cola National Sales Director – Kmart Beverage Account

Circumstances:
1) Kmart called and pressured Bixler, who initially resisted.
2) Kmart threatened to give an additional 10 million cases of business to Coca-Cola.
3) Kmart threatened to break the Pepsi contract.

Action: Initially was reluctant to sign the confirmation in writing. Instead, he met with PwC and falsely confirmed $3 million worth of allowances verbally.
Ahold/U.S. Foodservice

Vendor: Ahold/U.S. Foodservice
Timeframe: 2 Year Period, 2001 & 2002
Fraud: $700+ million of fake revenue
Ahold/U.S. Foodservice

Responders
1) Carl A. Allen – CEO, Heritage Bag
2) Donald Childers – Sales Manager, Sara Lee Food
3) John Crowder – Account Manager, Con Agra Foods-Poultry Group
4) Chris Jakubek – Sales Manager, Sara Lee Bakery Group
5) John King – Independent Food Broker
6) Steve LeBarron – Independent Food Broker
7) Patrick Penderghast – Director of Corporate & National Accounts
8) Frank Riggio – Vice President for Corporate Accounts
9) Richard Vecchia – Vice President of Sales, Sugar Foods
10) Gary Bell – Business Development, Hunt-Wesson Foodservice
11) Anthony Holoman – Sales Representative, C.F. Sauer Foods
12) Joseph Grendys – Owner, Koch Poultry
13) Michael Smith – Corporate Accounts, Citrus World
Ahold/U.S. Foodservice

- Aided and abetted a massive financial fraud by **signing and returning materially false audit confirmations** sent to them by the auditors of the U.S. Foodservice, Inc. subsidiary of Royal Ahold (Koninklijke Ahold N.V.).

- U.S. Foodservice personnel **contacted vendors and urged them to sign and return the false confirmation letters**. In some cases U.S. Foodservice pressured the vendors; in other cases they provided side letters to the vendors assuring the vendors that they did not owe U.S. Foodservice the amounts reflected as outstanding in the confirmation letters.
Ahold/U.S. Foodservice

- Each of the individuals aided and abetted the fraud by signing and sending to the company’s independent auditors confirmation letters that they knew materially overstated the amounts of promotional allowance income paid or owed to U.S. Foodservice. The amounts overstated in the confirmations were often inflated by millions of dollars and by more than 100 percent.
70+ Confirmation Fraud Examples

48 in the Last 12 Years!

- Boshiwa (2012)
- Advanced Battery Technologies (2011)
- Olympus (2011)
- Sino-Forest (2011)
- China Biotics (2011)
- Longtop (2011)
- ShengdaTech (2011)
- China New Century Media (2011)
- China MediaExpress (2011)
- China Integrated (2011)
- Electronic Game Card (2010)
- Satyam (2009)
- Take-Two Interactive (2007)
- Refco (2006)
- Daisytek International (2006)
- Lipper Holdings (2006)
- Kmart (2005)
- Royal Ahold (2005)
- Just for Feet (2005)
- e-Safetyworld (2005)
- Del Global Technologies Corporation (2005)
- Parmalat (2004)
- Suprema Specialties (2004)

- Amicom (2004)
- Safescript (2003)
- Barings (2003)
- Cronos (2002)
- Ebix (2002)
- PictureTel (2002)
- Healthsouth (2001)
- Allfirst Financial (2001)
- Quintus (2001)
- I&J Bagel/Manhattan Bagel (2001)
- American Bank Note Holigraphics (2001)
- Madera International (2001)
- Pier 1 Imports (2000)
- Three Point Digital (2000)
- Digital Lava (2000)
- Livent (1999)
- Just for Feet (1999)
- CF Foods (1999)

- Sunrise Medical (1999)
- Laser Photonics (1999)
- YBM (1998)
- Hybrid Networks (1997)
- Physician Computer Network (1997)
- Cambridge Biotech (1996)
- Pathe Communications (1996)
- Happiness Express (1995)
- Bio Clinic (1995)
- Northstar Health Services (1995)
- Kurzweil Applied Intelligence (1995)
- Standard Oil & Exploration of Delaware (1995)
- Refco (1991)
- Datamag (1991)
- BCCI Bank (1990)
- RSI (1988)
- ZZZZ Best Carpet Cleaning (1987)
- 18 Utah Companies (1987)
- Flight Transportation (1985)
- J.B. Hanauer & Company (1983)
- ...McKesson & Robbins (1930’s)
Responding Companies Should Control the Process

<table>
<thead>
<tr>
<th>Issue</th>
<th>Online Confirmations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Who sent the confirmation?</td>
<td>Authenticate the Accountant/Firm</td>
</tr>
<tr>
<td>Where does the response go?</td>
<td>Validate the recipient</td>
</tr>
<tr>
<td>Who performed the work within your company?</td>
<td>Limit to only designated and authorized personnel</td>
</tr>
<tr>
<td></td>
<td>Consistent request channel for all confirmations</td>
</tr>
</tbody>
</table>
Online Audit Confirmations
Confirmation.com
Control Audit Confirmation Responses

- Self-registration takes 3 minutes
- **FREE!** – no hardware or software required
- Automatically routes requests to the correct department!
- Secure, easy-to-use, online platform
- Ranked #169 in 2011 *Inc. 500* List

Have your Accounts Payable Department register today – go to **Confirmation.com**
Thank You!

To learn more visit Confirmation.com