

# External Auditing

## Learning Area Overview



### Welcome to this learning area overview for External Auditing, prepared by AAT.

In this overview we'll explain what External Auditing is all about, and how it fits into the bigger picture of the AAT Accounting Qualification.

We'll explore the main topics you can expect to cover, and how the knowledge and skills you'll pick up will be of practical use to you in the workplace.

Finally, we'll explain how this learning area relates to the others you've already studied, and those you'll study in the future.

### What you'll learn in External Auditing

To understand what's covered in External Auditing you first need to appreciate what an external audit is.

In very simple terms, an external audit is the independent examination of a set of financial statements by a suitably qualified person: the external auditor.

The main objective of an audit of financial statements is to allow the external auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable accounting framework.

The need for an external audit stems from the fact that for companies there's a distinction between the owners of a business – in other words, the shareholders – and the management of a business – that is, the directors who run the company on a day-to-day basis on behalf of the shareholders.

Financial statements are prepared by the directors mainly so that they can be seen to be accounting to the shareholders for their management of the company.

The external auditor's responsibility is to examine the financial statements and to report their opinion on whether they give a true and fair view.

The purpose of AAT's External Auditing unit is to ensure that you understand the fundamentals of how the audit process works, and to enable you to contribute to the conduct of an external audit.

There are five main areas in External Auditing. Let's take a look at each of these now.

The first area focuses on the legal and professional standards which an external auditor has to meet when carrying out their work. For this part of External Auditing you'll need to be able to demonstrate an understanding of the relevant legislation and auditing standards affecting external auditors, and also their legal and ethical duties.

The second area covers how an external auditor should plan and organise their work. External auditors only have a limited amount of time in which to complete their examination of financial statements, so they need to make sure they plan, control and record their work in an efficient and effective manner.

One of the consequences of having to work under this sort of time pressure is that the external auditor will usually not be able to check everything. This means they'll often need to use a variety of sampling techniques to make sure they address all of the critical areas of the audit.

External auditing also covers other important planning concepts, such as audit risk and materiality.

The third topic area concerns the work the external auditor must perform on their clients' accounting systems. A robust accounting system is absolutely essential if a business is to be able to produce financial statements that are free from material misstatements.

The external auditor needs to establish and document how a client's accounting system works. It's also important for them to understand what sort of internal controls management have built into the system, in order to make sure all of the organisation's transactions are properly captured and accurately recorded.

The audit procedures that the external auditor carries out on a client's accounting systems to evaluate how well it's operating are known as "tests of control".

Sometimes a business will have established its own internal audit department to assist management in maintaining an adequate accounting and internal control system.

If this is the case, part of the work that the external auditor performs will be to assess the effectiveness of the client's internal audit function.

The next area covers the detailed checking work that the external auditor needs to carry out on the financial statements at the end of the accounting period.

The external auditor needs to obtain enough appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion.

The detailed checking of the amounts included in the financial statements is known as “substantive testing”, and requires the auditor to carry out procedures that include agreeing items to source documents, reworking calculations and obtaining third party confirmation of balances.

The fifth and final area concentrates on the conclusion of the audit engagement, and how the evidence collected during the audit is reviewed and reported on.

The main report that the external auditor produces is addressed to the shareholders of the company, and confirms whether the external auditor believes that the financial statements are true, fair and properly prepared.

In addition, the external auditor also provides feedback to management on any weaknesses in the organisation’s accounting and internal control system that were identified during the course of the audit, along with their recommendations on how these problems should be resolved.

### How External Auditing will help you in the workplace

Many AAT members work for firms of chartered accountants who undertake substantial amounts of external audit work.

If you work as part of an external audit team, the External Auditing learning area will be hugely relevant to your day to day work and give you a comprehensive insight into why and how external audits are carried out.

Or, like a large number of other AAT members, you might find yourself working in the accounting function of a commercial organisation that is the subject of external audits.

As a result you’ll regularly find yourself on the receiving end of an external audit visit. In this case External Auditing will help you understand what the process entails.

Finally, irrespective of the type of organisation you work in, this unit will make it clear why it’s important to maintain an effective accounting system, and also why you need to be aware that you may have to make improvements to an accounting system to ensure it continues to operate effectively.

### How External Auditing relates to other learning areas

External Auditing is one of the four optional learning areas at this level. You’ll need to take a total of two of these, with the other optional learning areas being:

- Credit Management and Control
- Personal Tax
- Business Tax.

There are also four compulsory learning areas at level 4. These are:

- Financial Statements
- Budgeting
- Financial Performance
- Internal Control and Accounting Systems.

This is the first time that External Auditing is covered in the AAT Accounting Qualification. However, as this learning area is concerned with the audit of financial statements, it’s closely linked to the Financial Statements and Financial Performance compulsory learning areas at level 4, and also to Basic Accounting and Accounts Preparation previously covered at levels 2 and 3 respectively.

Some aspects of External Auditing overlap with the compulsory learning area at level 4 covering Internal Control and Accounting Systems. For example, the parts relating to how management set up an accounting system capable of producing accurate financial statements.

In addition there are sections of Professional Ethics in Accounting and Finance (which you will have met at either level 2 or level 3) that cover areas of relevance to External Auditing. These include topics such as the ethical duties of the auditor, the concept of auditor independence and objectivity, the auditor’s duty of care and the consequences of audit failure.

External Auditing also develops one of the six core ethical principles: confidentiality. It sets out the circumstances when this professional duty can be overridden, such as when an auditor suspects that their client may be involved in money laundering.

