



AAT

External Auditing

Pocket Notes

These Pocket Notes support study for the following AAT qualifications:

AAT Professional Diploma in Accounting – Level 4

AAT Level 4 Diploma in Business Skills

AAT Professional Diploma in Accounting at SCQF Level 8

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Preface

These Pocket Notes contain the key points you need to know for the exam, presented in a unique visual way that makes revision easy and effective.

Written by experienced lecturers and authors, these Pocket Notes break down content into manageable chunks to maximise your concentration.

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The slide features several thick, overlapping, light pink curved lines that sweep across the page from the bottom left towards the top right, creating a dynamic, abstract background.

A guide to the assessment

- Overview of the assessment.
- The keys to success in external auditing.

Overview of the Assessment

External Auditing (ETAU) is an optional unit.

ETAU is assessed by means of a computer based assessment. The CBA will last for 2 hours and consist of 23 tasks.

The assessment consists of 23 tasks, with a time allowed of two hours. The assessment contains the following question types:

- drag and drop
- pick list
- MCQs
- text selector
- extended writing.

There are three extended writing tasks covering the following assessment criteria:

- Provide clear information and recommendations for the proposed audit plan for submission to the appropriate person for consideration.

- Establish the existence, completeness, ownership, valuation and description of assets and liabilities and gather appropriate evidence to support these findings.
- Prepare and submit clear and concise draft reports with recommendations.

Each of the other assessment criteria may be assessed by any other question type.

In any one assessment, learners may not be assessed on all content, or on the full depth or breadth of a piece of content. The content assessed may change over time to ensure validity of assessment, but all assessment criteria will be tested over time.

Learning outcomes & weighting

1	Demonstrate an understanding of the principles of auditing	5%
2	Demonstrate the importance of professional ethics	12%
3	Evaluate the audited entity's system of internal control	15%
4	Evaluate audit procedures for obtaining audit evidence	15%
5	Evaluate the planning process	33%
6	Evaluate audit procedures	20%
Total		100%

When you have completed External Auditing, you should be competent in planning and performing an audit and in drafting related reports. While you would not be expected to take full responsibility for an audit, you should be able to carry out audit tests and document your findings to a point where those sections of the audit file are ready for review by a more senior member of the audit team.

Throughout your assessment you must demonstrate knowledge of best auditing practices as set out in International Standards on Auditing (UK and Ireland). These Pocket Notes are based on the mandatory procedures contained in these Standards.

Pass mark

To pass a unit assessment, students need to achieve a mark of 70% or more.

This unit contributes 10% of the total amount required for the Professional Diploma in Accounting qualification.

The keys to success in external auditing

Studying for this Unit

It is not enough simply to learn a list of the financial statement assertions (completeness, existence, etc). You must be able to devise and carry out audit tests which would test each assertion in a given scenario.

The AAT constantly stress the worth of being able to 'do' as well as to 'know how to'. The assessment is designed to enable you to demonstrate practical relevant competence, rather than an ability to rote-learn lists of facts.

chapter

1

Principles of auditing

- Overview.
- What is an audit?
- Important principles in audit work.
- Auditing standards.
- Diagram of stages in an audit.

Overview

This chapter deals with:

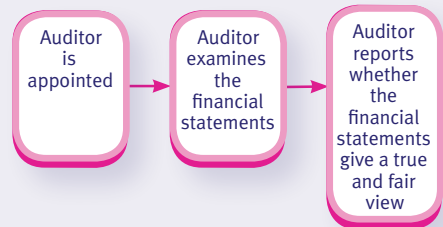
- The purpose and nature of an audit
- Key principles of auditing
- The regulation of auditing – auditing standards
- The stages involved in the audit process.

What is an audit?

Definition

An audit is the independent examination of the evidence from which the financial statements are derived, in order to give the reader of those statements confidence as to the truth and fairness of the state of affairs of the entity.

Outline of the annual external audit process



Requirement for audit

In the UK, Company Law requires all publicly quoted companies and all large companies (defined as those with turnover greater than £10.2 million) to appoint external auditors who will report whether the financial statements i.e. the statement of financial position, statement of profit or loss account, statement of changes in equity (or similar), statement of cash flows and notes, give a true and fair view.

Other organisations (e.g. small private companies, partnerships, etc) may choose to be audited, but there is no legal requirement.

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



CBA focus

It is not the auditor's responsibility either to prepare the financial statements or to ensure that the financial statements do give a true and fair view. The auditors simply report on whether, in their opinion, a true and fair view is given.

The wording of the standard audit report is shown in Appendix 1 of these Pocket Notes.

Important principles in audit work

- **True and fair** – the auditor does not report whether the figures in the financial statements are 100% correct. There are many judgements involved in a set of financial statements, so instead the opinion is given on whether the statements are true and fair.
- **Materiality** – there will be a maximum amount of error that the auditor is prepared to accept and still be satisfied that the financial statements show a true and fair view. He is only looking for material misstatements, a concept looked at further in Chapter 3.
- **Reasonable assurance** – the auditor does not guarantee 100% that he has detected all material misstatements. Owing to limitations in the work he carries out (e.g. looking at samples of items rather than every item), he offers only reasonable assurance in his report.

Auditing standards

The Auditing Practices Board (APB) is responsible for developing and publishing UK and Irish auditing standards. It does this by looking at the **International Standards on Auditing** (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB), adding any supplementary material deemed necessary in the UK and Irish context, and then issuing each supplemented standard as an ISA (UK and Ireland).

The range of APB pronouncements on auditing is set out in the diagram overleaf. Each is then explained in more detail.



- **International Standards on Quality Control (ISQCs)** help firms to carry out audits to a consistently high quality.

- **The Auditors' Code** is a short list of principles (integrity, objectivity and independence, competence, etc) which the APB expect auditors to follow in their work.
- Ethical Standards (ESs) are concerned with the integrity, objectivity and independence of auditors.
- **International Standards on Auditing (ISAs)** contain mandatory guidance that must be followed by auditors, as well as other non mandatory explanatory material.
- **Practice Notes** set out recommended best practice in particular circumstances and industries.
- **Bulletins** provide timely recommended guidance on new or emerging issues.

Diagram of stages in an audit

Stage

1

Invited to become auditor

2

Do you wish to accept appointment?

No → Decline

Yes

3

Send professional etiquette letter to outgoing auditor

Problems → Decline

No Problems

4

Send engagement letter to directors

5

Plan the audit

Assessment of the accounting and internal control systems and the level of audit risk

Stage

6

Good controls

Weak controls

Testing of internal controls

Not operating satisfactorily

7

Reduced testing of transactions and balances

Operating satisfactorily

Extensive testing of transactions and balances

8

Overall review of the financial statements

9

Audit report

10

Report to those charged with governance (management letter)

11

Stages of the audit

- 1 The auditor is approached by a company with a view to being nominated as the company's auditor.
- 2 The auditor will consider:
 - Ethical matters – e.g. independence
 - Legal matters
 - Practical matters – e.g. does the auditor have the staff available when required to do the audit?
- 3 The auditor will write to the previous auditors asking if there are any reasons why the auditor should hesitate before being appointed.
- 4 The engagement letter records in writing the contractual basis of the relationship between the auditor and the company, in order to avoid possible misunderstandings in the future.
- 5 The auditor must plan in order that the audit will be performed in an effective manner.
- 6 The auditor carries out risk assessment procedures to learn about the entity and its internal controls.
- 7 If this preliminary evaluation of internal controls suggests that they are strong then their actual performance in practice is tested (tests of control).
- 8 If the controls are operating satisfactorily, then only a reduced amount of detailed testing (substantive procedures) is required to maintain audit risk at an acceptable level. If the controls are believed to be weak, or are not operating satisfactorily, then extensive substantive procedures will be necessary to reduce audit risk to an acceptable level.

Principles of auditing

- 9 Once all the detailed audit testing is complete, the auditor should review the financial statements as a whole.
- 10 The auditor should issue the audit report which is published with the financial statements in the Annual Report document.
- 11 The auditor should report any deficiencies found in internal control to the directors, in a management letter.