

# UNIT 2

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## UNIT MAP

<b>Reading 1:</b>	Engagement letter
<b>Reading 2:</b>	Preparing for an audit
<b>Focus on Vocabulary:</b>	Collocations
<b>Language Task:</b>	Establishing audit strategy
<b>Grammar in Action:</b>	Present Continuous Tense: Talking about current engagements
<b>Writing Task:</b>	Engagement letter
<b>Extra Activity 1:</b>	A pre-engagement interview
<b>Extra Activity 2:</b>	Choose the correct option

**SECTION 1**

**READING 1 KEY VOCABULARY**

engagement letter;	terms of engagement;	time frame;
appointment;	pre-engagement assessment;	suspicious;
scope;	extent liability;	misunderstanding;
professional jargon;	legally binding;	reasonable assurance;
duty of care;	materiality;	negligence;

**1. INTRODUCTION TO READING 1**

Reading 1 focuses on an engagement letter, a document prepared before the engagement is accepted. An engagement letter defines the terms of engagement and other key aspects of the audit, such as the audit scope or the extent of the auditor’s liability towards the client.

**2. TOPIC PREVIEW: THE KEY**

1. What is an engagement letter?  
*It is a written agreement between the audit firm and a new client.*
2. What is the purpose of an engagement letter?  
*Its purpose is to clarify the extent of auditor’s work and avoid misunderstanding with the client.*
3. What is meant by the term ‘auditor’s liability’?  
*It is the legal responsibility of the auditor.*

**3. VOCABULARY PREVIEW: THE KEY**

1. engagement letter	C. is a written agreement between the audit firm and a new client
2. legally binding	A. is something that must be obeyed by law
3. negligence	D. is when the auditor does not perform an audit according to standards
4. duty of care	E. is the auditor’s responsibility to provide quality professional services
5. materiality	B. is the quality of information whose omission could lead users of financial statements to make wrong decisions

1: C; 2: A; 3: D; 4: E; 5: B

## 4. READING 1: DISCUSSION

1. How do audit firms find new clients?  
*Students provide answers based on their opinions and experience.*
2. What is the first step in the audit process?  
*The first step is the preparation of an engagement letter.*
3. What is an engagement letter?  
*It is a written agreement between the audit firm and a new client.*
4. Why do audit firms need to evaluate potential clients before accepting an engagement?  
*They evaluate potential clients because accepting a suspicious client might damage the firm's reputation.*
5. What is the purpose of an engagement letter?  
*The purpose of an engagement letter is to clarify the extent of auditor's work and avoid misunderstanding with the client.*
6. What aspects of an engagement are defined by the engagement letter?  
*The engagement letter defines the terms of engagement, time frame, audit objectives, audit scope and the extent of the auditor's responsibilities.*
7. What is the auditor's responsibility towards the client?  
*The auditor is responsible for reporting on whether the financial statements as a whole are true and fair. The auditor is not responsible for preventing fraud.*
8. What is the management's responsibility towards the auditor?  
*The management is responsible for preparation of information that is accurate and in compliance with the relevant laws and regulations.*
9. What term is used in the professional jargon to describe the auditor's responsibility to provide quality professional services?  
*Duty of care.*
10. What term is used in the professional jargon to describe the situation when the auditor does not perform the audit according to professional standards?  
*Negligence.*
11. What could be a possible result of a disagreement between the audit firm and the client?  
*The disagreement could result in a legal dispute between the client and the audit firm.*

## 5. COMPREHENSION CHECK: THE KEY

1. True
2. False
3. False

## 6. SPEAKING 1

Let students speak freely and do not overcorrect.

**SECTION 2**

**1. FOCUS ON VOCABULARY: THE KEY**

1. After completing the pre-acceptance procedure, the audit firm **prepares** the engagement letter.
2. The new contract should clearly **stipulate** the terms of engagement.
3. The auditor’s duty to **detect** fraud relates to fraudulent financial reporting and misappropriation of company funds.
4. The court found that the auditor **owed** duty of care to shareholders and was held responsible for the loss.
5. The document defines the **extent** of the auditor’s liability to third parties for negligent work.
6. A new version of the letter was written because it did not clearly **state** the objective of the engagement.

**2. LANGUAGE TASK: THE KEY**

1. The auditor establishes the overall	G. strategy for the engagement.
2. The audit strategy outlines	A. the scope, timing and direction of the audit.
3. The auditor develops	H. an audit plan.
4. The auditor identifies the characteristics	C. of the engagement that define its scope.
5. The auditor ascertains the reporting	F. objectives of the engagement.
6. The auditor considers the results of preliminary	E. engagement activities.
7. The auditor effectively allocates	B. the resources to the audit team.
8. The auditor considers the knowledge	D. gained on other engagements.

1: G; 2: A; 3: H; 4: C; 5: F; 6: E; 7: B; 8: D;

**3. GRAMMAR IN ACTION: THE KEY**

Students prepare their own questions using the Present Continuous Tense.

**Example:**

*What are your current professional engagements?*

*I am currently working on an audit of a new client.*

**SECTION 3**

**READING 2 KEY VOCABULARY**

fieldwork;	preliminary engagement activities;	ethical requirements;
audit strategy;	audit plan;	approach;
audit assignment;	existing client;	preliminary knowledge;
regulatory environment;	internal controls;	reporting requirements;

**1. INTRODUCTION TO READING 2**

Reading 2 focuses on the audit strategy and the audit plan, two essential documents prepared in the planning phase of an audit. These two documents are created to guide the auditor during an audit. The audit strategy is a general approach to an audit, while the audit plan gives the auditor detailed instructions on how to perform an audit.

**2. TOPIC PREVIEW: THE KEY**

1. What are the different stages of the audit process?  
*The audit process typically involves three main stages: planning, fieldwork and reporting.*
2. What is the difference between the audit strategy and the audit plan?  
*The audit strategy is a general approach to an audit. The audit plan outlines specific procedures carried out to implement the strategy.*
3. What matters are considered by the auditor when establishing the audit strategy?  
*When establishing the audit strategy, the auditor takes into account the characteristics of the engagement and its scope; reporting requirements, the resources necessary to perform the audit and the results of preliminary engagement activities;*

**3. VOCABULARY PREVIEW: THE KEY**

1. preliminary engagement activities	B. are the activities the auditor undertakes at the beginning of an engagement to prevent possible problems in future
2. approach	E. is a method used in dealing with something
3. audit strategy	A. is a general approach adopted by an auditor to a specific audit engagement
4. audit plan	C. is a list of specific procedures carried out to implement the audit strategy
5. financial reporting	D. is a standard accounting practice that uses financial statements to disclose a company's financial information and performance over a particular period

1: B; 2: E; 3: A; 4: C; 5: D;

## 4. READING 2: DISCUSSION

1. How many stages does a typical audit engagement have?  
*An audit engagement typically has three stages: planning, fieldwork and reporting.*
2. What steps does the planning phase involve?  
*The planning phase involves the following steps: performing preliminary engagement activities, establishing the overall audit strategy and developing the audit plan.*
3. What is the purpose of preliminary engagement activities?  
*The purpose of preliminary engagement activities is to ensure that the auditor has considered all events or circumstances that might adversely affect the audit. In simple terms, their purpose is to prevent that something goes wrong with the audit.*
4. What specific procedures do preliminary engagement activities include?  
*Preliminary engagement activities include the following:*
  - *performing procedures regarding the continuance of the client relationship;*
  - *evaluating compliance with relevant ethical requirements, including independence;*
  - *establishing an understanding of the terms of engagement;*
5. What is an audit strategy?  
*An audit strategy is a general approach adopted by the auditor to a specific audit assignment.*
6. What are the objectives of an audit strategy?  
*It sets out in general terms how the audit is to be conducted and sets the scope, timing and direction of the audit.*
7. What must the auditor take into consideration when establishing an audit strategy?
  - *the characteristics of the engagement that define its scope*
  - *the reporting requirements*
  - *the nature, timing and extent of the resources necessary to perform the audit*
  - *the results of preliminary engagement activities*
8. What is an audit plan?  
*It is a list of specific procedures carried out to implement the audit strategy.*
9. What must the auditor do when planning an audit for a new client?  
*The auditor needs to obtain a complete understanding of the client and its business and to evaluate the client's internal controls.*
10. How does the understanding of the entity help the auditor?  
*It enables the auditor to identify events and transactions that are likely to have a significant effect on financial statements.*

## 5. COMPREHENSION CHECK: THE KEY

1. True
2. False
3. False

## 6. SPEAKING 2

Let students speak freely and do not overcorrect.

## 7. WRITING TASK: Assign the writing task for homework.

Assign the writing task for homework.

### Sample Answer:

Dear [*Client Name*],

We are writing to confirm the details of our agreement to audit your financial statements for the year ending [*Year*]. This letter sets out the terms of our engagement as your auditors.

Our audit will begin on [*Start Date*] and end on [*End Date*]. Our objective is to express an opinion on the financial statements of [*Client Name*] for the year ended [*Year*] in accordance with International Standards on Auditing. Our audit will be conducted in accordance with the applicable financial reporting framework, which is [*Framework Name*]. We will report any weaknesses or significant deficiencies in internal controls we identify during our audit, and will offer suggestions for improvement where appropriate.

As the management of the company, you are responsible for preparing the financial statements in accordance with the applicable financial reporting framework. You are also responsible for ensuring that we have access to all necessary information and explanations to carry out our audit.

We will provide a report on the financial statements of [*Client Name*] for the year ended [*Year*] in accordance with International Standards on Auditing. The report will be addressed to the shareholders of the company and will express our opinion on the financial statements.

Our fee for this audit will be [*Amount*]. This fee is based on the estimated time and level of staff required to complete the audit, and will be invoiced in accordance with our standard terms and conditions.

Please sign and return the enclosed copy of this letter to confirm that it is in accordance with your understanding of the arrangements for the audit of the financial statements for the year ended [*Year*]. If you have any questions or require any further information, please do not hesitate to contact us.

Yours Sincerely,  
(*Signature*)

<b>EXTRA ACTIVITIES</b>
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## UNIT 2 Extra Activity 1: A pre-engagement interview

**Student A:** You are a manager of a mid-sized company, and you need to engage external auditors to perform a statutory audit. You want to choose a competent and reliable audit firm, because an inaccurate or incomplete audit could create serious problems. Use the prompts below and your own ideas to determine the quality of the prospective audit firm.

- discuss the audit plan with the audit team
- make sure they understand company-specific areas of financial reporting
- find out how well they understand the company's business, industry and economic environment
- find out what industry expertise they have
- find out how able they are to demonstrate independence
- find out what safeguards they have to protect independence
- find out about their process for overseeing the audit quality
- find out how they ensure that standards are met and methodologies followed
- find out how extensively the audit file is reviewed before the issuance of the report
- discuss the audit fees
- any other issues you find relevant



**Student B:** You are an audit manager. You are preparing for an interview with a manager of a mid-sized company concerning a possible engagement. Below are some of the issues that you might discuss with him or her. Prepare yourself in advance.

- discuss the audit plan with the company's management
- demonstrate that you understand company-specific areas of financial reporting
- demonstrate your understanding of the company's business, industry and economic environment
- prove that you have the industry expertise
- prove that you are able to demonstrate independence
- prove that you have safeguards to protect independence
- demonstrate the process for overseeing the audit quality
- describe how you ensure that standards are met and methodologies followed
- describe how you review the audit file before the issuance of the report
- discuss the audit fees
- any other issues you find relevant



## UNIT 2 Extra Activity 2A

Complete the sentences with a missing word:

1. signing	2. care	3. reputation	4. dispute	5. binding
6. negligence	7. terms	8. action	9. letter	10. liability

1. Why do audit firms need to evaluate potential clients before accepting an engagement?  
Because accepting a suspicious client might damage the firm's \_\_\_\_\_ .
2. What might happen if a client is not happy with the quality of services of an audit firm?  
A client might take a legal \_\_\_\_\_ against the audit firm.
3. In professional jargon, what term describes auditor's responsibility to provide quality professional services?  
Duty of \_\_\_\_\_ .
4. In professional jargon, what term describes the situation when an auditor does not perform an audit according to professional standards?  
\_\_\_\_\_ .
5. What is the possible result of a disagreement between an audit firm and a client?  
This could result in a legal \_\_\_\_\_ between an audit firm and a client.
6. What document is prepared to prevent possible disagreements between an audit firm and a client?  
An engagement \_\_\_\_\_ .
7. What is an engagement letter?  
A written document used by auditors when \_\_\_\_\_ a new client.
8. What aspects of an engagement are defined by an engagement letter?  
It defines the \_\_\_\_\_ of engagement, time frame, audit objectives and audit scope.
9. In professional jargon, what is another term for auditor's responsibility to a client?  
Auditor's \_\_\_\_\_ .
10. In professional jargon, what term is used to say that an engagement letter is a legal document?  
Legally \_\_\_\_\_ .

## UNIT 2 Extra Activity 2A: THE KEY

1. Why do audit firms need to evaluate potential clients before accepting an engagement?  
Because accepting a suspicious client might damage the firm's **reputation**.
2. What might happen if a client is not happy with the quality of services of an audit firm?  
A client might take a legal **action** against the audit firm.
3. In professional jargon, what term describes auditor's responsibility to provide quality professional services?  
Duty of **care**.
4. In professional jargon, what term describes the situation when an auditor does not perform an audit according to professional standards?  
**Negligence**.
5. What is the possible result of a disagreement between an audit firm and a client?  
This could result in a legal **dispute** between an audit firm and a client.
6. What document is prepared to prevent possible disagreements between an audit firm and a client?  
An engagement **letter**.
7. What is an engagement letter?  
A written document used by auditors when **signing** a new client.
8. What aspects of an engagement are defined by an engagement letter?  
It defines the **terms** of engagement, time frame, audit objectives and audit scope.
9. In professional jargon, what is another term for auditor's responsibility to a client?  
Auditor's **liability**.
10. In professional jargon, what term is used to say that an engagement letter is a legal document?  
Legally **binding**.

## UNIT 2 Extra Activity 2B

Choose the correct option:

1. If you stipulate the terms of engagement, you
  - A. specify the terms of engagement
  - B. impose the terms of engagement
  
2. If you outline the time frame of an audit, you
  - A. cut the time frame of an audit
  - B. define the time frame of an audit
  
3. If you state the objective of an audit, you
  - A. achieve the objective of an audit
  - B. specify the objective of an audit
  
4. If you confirm the appointment of someone, you
  - A. give approval to the appointment of someone
  - B. postpone the appointment of someone
  
5. If you talk about the extent of the auditor's liability, you talk about
  - A. the importance of the auditor's liability
  - B. the scope of the auditor's liability
  
6. If you sue someone, you
  - A. take a legal action against someone
  - B. complain against someone
  
7. If you owe duty of care to someone, you
  - A. need to pay money to someone
  - B. are obligated to provide quality services to someone
  
8. If you go beyond the concept of materiality, you
  - A. exceed the concept of materiality
  - B. introduce the concept of materiality

## UNIT 2 Extra Activity 2B: THE KEY

Choose the correct option:

1. If you **stipulate** the terms of engagement, you
  - A. specify the terms of engagement
  
2. If you **outline** the time frame of an audit, you
  - B. define the time frame of the audit
  
3. If you **state** the objective of an audit, you
  - B. specify the objective of an audit
  
4. If you **confirm** the appointment of someone, you
  - A. give approval to the appointment of someone
  
5. If you talk about the **extent** of the auditor's liability, you talk about
  - B. the scope of the auditor's liability
  
6. If you **sue** someone, you
  - A. take a legal action against someone
  
7. If you **owe** duty of care to someone, you
  - B. are obligated to provide quality services to someone
  
8. If you **go beyond** the concept of materiality, you
  - A. exceed the concept of materiality