



Corporate Supervision Department  
Company Law Division

Before Abid Hussain – Executive Director

*In the matter of*

**S. Zafar Shah & Co. Chartered Accountants**  
**Auditor of AHN Colloid Chemical (Pvt.) Limited**

Number and date of notice: CSD/ARN/26/2015-708 dated September 18, 2015  
Date of hearings: February 22, 2016  
Present: Barrister Fahad Masud Lone- Authorized Representative  
Mr. Aitzaz Hussain

**ORDER**

**UNDER SECTION 260 READ WITH SECTION 255 & 476 OF THE COMPANIES ORDINANCE, 1984**

This order shall dispose of the proceedings initiated against S. Zafar Shah & Co. Chartered Accountants (“respondent”) through show cause notice (the “SCN”) dated September 18, 2015 under the provisions of Section 260 read with Section 255 and 476 of the Companies Ordinance 1984 (the “Ordinance”).

2. Brief facts of the case are that examination of financial statements (the “financial statements”) of AHN Colloid Chemical (Pvt.) Limited. (the “Company”) for the year ended June 30, 2012 revealed that the Company revalued its “Building” and “Plant and Machinery”. The break-up of the amounts and the deferred tax impact is as follows:

Description	Year	Cost Rs. in (million)	Revalued Rs. in (million)	Difference Rs. in (million)	Deferred Tax Impact (Difference*35%)
Building	2009	14.514	51.750	37.235	13.032
	2010	51.750	76.786	25.036	8.762
Plant & Machinery	2009	38.072	45.047	6.942	2.429
	2010	45.047	120.079	75.032	26.261

3. As per Section 11 of Accounting and Financial Reporting Standard for Medium Sized Entities (“AFRS”) a deferred tax liability shall be recognized for all taxable temporary differences, except to the extent that the deferred tax liability arises from the initial recognition of goodwill or the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss). Current tax and deferred tax shall be recognized as income or an expense and included in profit or



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loss for the period, except to the extent that the tax arises from a transaction or event which is recognized, in the same or a different period, directly in equity); or a business combination. Current tax and deferred tax shall be charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or a different period, directly to equity.

4. The aforesaid deferred tax liabilities have not been accounted for despite of significant amount of revaluation of fixed assets. The amount and effects of above referred observations are material. The financial statements of the Company do not give a true and fair view of its affairs as at June 30, 2012.

5. As per Para 11 of International Standards on Auditing (the "ISA") 200 in conducting the audit of financial statements, the overall objectives of the auditor are:

- a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material aspects, in accordance with an applicable financial reporting framework: and
- b) To report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor's findings.

6. Para 15 of ISA 200 provides that the auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.

7. Para 7(a) of ISA 705 requires that an auditor shall express a qualified opinion when the auditor, having obtained sufficient appropriate evidence, concludes that misstatements, individually or in the aggregate are material, but not pervasive, to the financial statements.

8. The Audit Report (the "Report") to the members of the Company does not include a qualification based on the above observation. Therefore, SCN was issued to the respondent for, prima facie, contravention of Section 255 of the Ordinance. The respondent failed to reply the SCN.



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9. In order to provide opportunity of personal hearing; the case was fixed before the undersigned on February 22, 2016. Mr. Barrister Fahad Masud Lone- Authorised Representative and Mr. Aitzaz Hussain appeared before the undersigned and submitted that misstatement is not material, deferred tax has no impact on cash flows, the company is a private company and it is only a procedural error on part of auditor. However, he assured meticulous compliance of the requirements of law and relevant AFRS in future.

10. Before proceeding with the order, it is appropriate to quote the provisions of Section 255(3) of the Ordinance stipulating duties of auditors. It requires that the auditor shall make a report to the members of the company on the accounts and books of account of the company and on every balance sheet and profit and loss account and on every other document forming part of the balance sheet and profit and loss account, including notes, statements or schedules appended thereto, which are laid before the Company in general meeting during their tenure of office, and the report shall state:

*(d) whether or not in their opinion and to the best of their information and according to the explanations given to them, the said accounts give the information required by this Ordinance in the manner so required and give a true and fair view in the case of the balance-sheet, of the state of the company's affairs as at the end of its financial year; in the case of the profit and loss account or the income and expenditure account, of the profit or loss or surplus or deficit, as the case may be, for its financial year; and in the case of the statement of changes in financial position or sources and application of funds of a listed company, of the changes in the financial position or the sources and application of funds for its financial year;*

11. Furthermore, the provisions of Section 255(4) of the Ordinance requires that where any of the aforesaid matters is answered in the negative or with a qualification, the report shall state the reason for such answer along with the factual position to the best of the auditors' information.

12. In terms of the Commission's notification SRO 1003 (I)/2015 dated October 15, 2015, the powers to adjudicate cases under section 260 of the ordinance have been delegated to Executive Director (Corporate Supervision Department).

13. I have analyzed the facts of the case; relevant provisions of the Ordinance, ISA, and arguments put forth by the respondent and observed the following:

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- a) The Company failed to comply with requirements of Section 11 of AFRS which requires that if an asset's carrying value is increased as a result of revaluation, the increase shall be recognized in other comprehensive income and accumulated in equity. Section 12 of AFRS requires current tax and deferred tax to be recognized outside profit or loss if the tax relates to items that are recognized outside profit and loss. The Company failed to charge deferred tax. Consequently:
- I. Deferred tax liability is understated by Rs. 15.461 million in 2009 and Rs. 35.023 million in 2010 and this misstatement is not corrected even in 2012 financial statements;
  - II. Surplus on revaluation of assets is overstated by Rs. 15.461 million in 2009 and Rs. 35.023 million in 2010 and this misstatement is not corrected even in 2012 financial statements;
  - III. Total other comprehensive income is overstated by Rs. 15.461 million in 2009 and Rs. 35.023 million in 2010.
- b) The Company is a medium sized company and has to follow AFRS for medium sized entities as are notified by the Commission in the official Gazette under Section 234 of the Ordinance. Section 11 of AFRS prescribes the accounting treatment of deferred taxes. Moreover, deferred tax accounting is vital for the fair presentation of the financial statements as it provides accurate calculation of accrual earnings and moderates earnings in accordance with the circumstances as they may prevail.
- c) The amount and effect of above referred observations are material; the financial statements for the year 2009 to 2012 do not give true and fair view.
- d) Deferred tax accounting is vital for the fair presentation of the financial statements as it provides accurate calculation of accrual earnings and moderates earnings in accordance with the circumstances as they may prevail.
- e) The auditor failed to highlight the aforesaid material misstatement in his report for the financial year 2012.

14. For the foregoing reasons, I am of the firm opinion that the respondent failed to bring out material facts about the affairs of the Company and accordingly audit report have not been made



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in conformity with Section 255 & 260 of the Ordinance and is liable for the penalty as prescribed by Section 260 of the Ordinance. However, keeping in the assurance given during the hearing, in exercise of the powers conferred by the aforesaid provisions of the Ordinance, I hereby issue a stern warning to the auditor with direction to be more vigilant in future in performance of his duties.

**Abid Hussain**  
Executive Director

**Announced:**  
March 15, 2016  
Islamabad