



Corporate Supervision Department
Company Law Division

Before Abid Hussain – Executive Director

In the matter of

M/s Javed Chaudhry & Co. Chartered Accountants
Auditor of Citifoam Industries Limited

Number and date of notice: CSD/ARN/253/2015-2784 dated January 21, 2016
Date of hearing: March 10, 2016
Present: Mr. Zaheer Abbas - Authorized Representative

ORDER

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

This order shall dispose of the proceeding initiated against Javed Chaudhry & Co. Chartered Accountants (“respondent”) through show cause notice (the “SCN”) dated January 21, 2016 under the provisions of Section 260 read with Section 255 and 476 of the Companies Ordinance 1984 (the “Ordinance”).

2. The facts leading to this case, briefly stated, are that, examination of audited financial statements (the “Accounts”) of Citifoam Industries Limited (the “Company”) for the year ended June 30, 2014 audited by M/s Javed Chaudhry & Co. Chartered Accountants (“auditor’s), revealed that no depreciation is charged on fixed assets of the Company which is non-compliance of Para 37 of Accounting and Financial Reporting Standard (“AFRS”) for Small Sized Entities (“SSE’s”) which require that *the depreciable amount (cost less expected proceeds from disposal) of an item of property, plant or equipment shall be allocated on a systematic basis over its useful life.*

3. The aforementioned contraventions with the para 37 of AFRS for SSE’s by the Company by not charging the depreciation on fixed assets in preparation of its Accounts, have, prima facie, caused material misstatements, as substantiated below:

(Amounts in Rs)

| Head of Account | Understated / Overstated | Figure Reported in Accounts | Amount of Misstatement due to incorrect treatment | Actual Accumulated Loss if correct treatment was applied | Misstatement as % of Actual Figures if correct treatment was applied |
|--|--------------------------|-----------------------------|---|--|--|
| Loss for the year | understated | (53,859) | (4,144,059) | (4,197,918) | 99% |
| Equity (on account of current year depreciation) | Overstated | 78,599,466 | (4,144,059) | 74,455,407 | 6% |
| Fixed Assets | Overstated | 50,538,306 | (4,144,059) | 46,394,247 | 9% |



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4. Para 8 of International Standard on Auditing ("ISA") 705 states that *the auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in aggregate, are both material and pervasive to the financial statements.*

5. Para 25 of AFRS for SSE's states that financial statements shall be prepared on a going concern basis unless management either intends to liquidate the entity or cease trading, or has no realistic alternative but to do so. As per directors' report to the members manufacturing activities are suspended since the year 2004. The Company is, prima facie, not a going concern, and management's use of going concern assumption in preparation of Accounts does not appear to be appropriate.

6. Relevant provisions of ISA 570 regarding auditor's responsibility in respect of going concern assumption are quoted below:

6. The auditor's responsibility is to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern. This responsibility exists even if the financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern.

11. The auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. (Ref: Para. A6)

12. The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern. (Ref: Para. A7-A9, A11-A12)

21. If the financial statements have been prepared on a going concern basis but, in auditors' judgment, management's use of going concern assumption in the financial statements is inappropriate, the auditor shall express an adverse opinion."

7. The respondent while making out their report to the members failed to express an adverse opinion with reference to aforesaid misstatement which is both material and pervasive and with

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specific reference to the fact of uncertainty with regard to going concern. The audit reports on the aforesaid accounts were prima facie, not in accordance with the requirements of Section 255 of the Ordinance and ISA and failed to bring out material facts about the affairs of the Company. Therefore, SCN was issued to the respondent for *prima facie*, contravention of Section 260 of the Ordinance.

8. The reply to SCN was submitted by the respondent vide letter dated February 8, 2016. The seriatim reply is summarized below.

- The Company is SSE as apparent from its financial statements and according to para 37 of AFRS for SSEs depreciable amount is the cost less expected proceeds from disposal where as in our case, the expected proceeds of assets is greater than the written down value of assets and it is reviewed every year since 2004, also unlike para 55 of International Accounting Standard ("IAS") 16, AFRS for SSEs do not restrict that company should charge depreciation even if assets are idle. The Company has assets which are idle since 2004, therefore the management decided to abandon to charge depreciation on the assets because charge of deprecation could mislead the actual financial decision of the Company.
- The Company has ceased the trading but has not intention to liquidate the entity and has realistic alternative to revive the Company in 2018 which has been duly checked, verified.

9. In order to provide opportunity of personal hearing; the case was fixed before the undersigned on September 10, 2015. Mr. Zaheer Abbas appeared and maintained the same plea as per written submissions.

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*



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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) 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, arguments put forth by the respondent in writing during the hearing and observed the following;

- The provisions of Section 255 are very clear and the spirit of the aforesaid provisions is that, the primary responsibility of the auditor is to opine on the Accounts of the Company after obtaining all the relevant and necessary information which is essential to form an opinion.
- The contraventions with the para 37 of AFRS for SSE's by the Company by not charging the depreciation on fixed assets in preparation of its Accounts, have, prima facie, caused material misstatements. The argument of respondent that AFRS for SSE's do not restrict that company should charge depreciation even if assets are idle is not cogent. AFRS for SME,s and medium sized entities are the basic guidance, for material transactions or events not covered by the standard, reference shall be made to the International Financial Reporting Standards and as per para 55 of IAS 16, deprecation begins when the asset is available for use and continues until the asset is derecognized, even if it is idle.
- The respondent stance that the Company maintains a going concern status is not tenable. As per ISA 570 the auditor's responsibility is to obtain sufficient appropriate audit

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evidence about the appropriateness of management's use of the going concern assumption in the preparation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern. The auditor needs to evaluate management's assessment of the entity's ability to continue as a going concern. Based on the audit evidence obtained, the auditor needs to conclude whether, in the auditor's judgment, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. When material uncertainty exists the auditor has to express a qualified opinion or adverse opinion, as appropriate, in accordance with ISA 705.

- Section 305 of the Ordinance stipulates that a company may be wound up by Court if the company does not commence its business within a year from its incorporation. In the instant case the respondent has expressed an unqualified opinion despite the Company suspend its business activities since 2004. The company is exposed to the risk of being wound up if the Commission or creditors so desires. This risk is exaggerated by the fact that the director's report does not indicate any plan for commencement of business nor does it disclose any efforts by the management to change the situation of the company. These indications cast significant doubt on the entity's ability to continue as going concern and make it incumbent on the respondents to assess the management's assumption on going concern.

14. For the foregoing reasons, I am of the firm opinion that the respondent failed to bring about material facts about the affairs of the Company and accordingly audit reports have not been made in conformity with Section 255 & 260 of the Ordinance and is liable for the penalty as prescribed by Section 260 of the Ordinance. Therefore, in exercise of the powers conferred by the aforesaid provisions of the Ordinance, I hereby impose a fine of Rs.5,000 (Rupees five thousand only) on the respondent.

The respondent is hereby directed to deposit fine of Rs.5,000 (Rupees five thousand only) in the designated bank account maintained in the name of Securities and Exchange Commission of Pakistan with MCB Bank Limited within thirty days from the receipt of this Order and furnish

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received vouchers for information and record, failing which proceedings under the Land Revenue Act, 1967 will be initiated.

Abid Hussain
Executive Director

Announced:
April 14, 2016
Islamabad