



Corporate Supervision Department
Company Law Division

SECP Before Abid Hussain – Executive Director (Corporate Supervision Department)

In the matter of

Ishtiaq Rana & Co. - Auditor of Atta Buksh Textile Limited

Number and date of notice: No. CSD/ARN/255/2015-2640, dated January 19, 2016
Date of hearing: March 31, 2016
Present: Mr. Javed Ahmed Rana and Syed Muhammad Ali

ORDER

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

This order shall dispose of the proceedings initiated against Mr. Laeeq Ahmad Rana (the "respondent"), audit engagement partner of Ishtiaq Rana and Co., Chartered Accountant (the "Auditor") in respect of audit of annual financial statements (the "Accounts") of Atta Buksh Textile Limited (the "Company") for the year ended June 30, 2014. The proceedings were initiated through show cause notice ("SCN") dated January 19, 2016 under the provisions of section 260 read with sections 255 and 476 of the Companies Ordinance 1984 (the "Ordinance").

2. The brief facts of the case are that examination of Accounts of the Company for the year ended June 30, 2014 filed under section 242 of the Ordinance revealed that under note 1 to the Accounts, the Company stated as under:

- (i) Until the year 2004 the Company was engaged in manufacturing and sale of textile products; and
- (ii) During the year ended June 30, 2004 the company discontinued its manufacturing activities, sold out its entire plant & machinery and leased out its building till July 2015.

It was further disclosed under note 1 to the Accounts that the Company decided to export readymade garments in the markets of Canada and the USA for which the Company was planning to setup a liaison office in Canada to further explore these markets. Having audited the Accounts, the Auditor expressed a clean report without any modification of opinion or adding any emphasis of the matter paragraph. In response to the Commission's queries regarding uncertainty about the Company's ability to continue as a going concern owing to above facts, the Auditor through letter dated December 11, 2015, inter alia, stated that in view of the following facts, they appropriately



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expressed opinion in compliance with all International Standards on Auditing ("ISA's") including ISA-570:

- (i) The company discontinued its manufacturing in 2004 and has been operating under lease arrangement for the last 10 years. The renewal of this agreement was due on its maturity on July 31, 2015. During audit, the matter was taken up with the management through management representation letter, who confirmed their plans and future intentions for renewal of lease arrangements.
- (ii) The subsequent financial statements for the period 2015, validated management representation in this regard.

3. In view of the facts mentioned in the preceding paragraphs including, inter alia, disposal of entire plant & machinery, discontinuation of the main business, leasing out of the building and approaching expiry of the lease agreement, material uncertainty existed regarding the Company's ability to continue as a going concern, as on June 30, 2014. Despite the aforementioned fact, the auditor in report to members on the Accounts, prima facie, failed to highlight the material uncertainty regarding Company's ability to continue as a going concern. Thus, the audit report on the Account was not in accordance with the requirements of section 255 of the Ordinance and the Auditor, prima facie, failed to bring out material facts about the affairs of the Company making him liable under section 260 of the Ordinance. Consequently the SCN was issued to the respondent who was audit engagement partner of the Auditor.

4. Since no response to the SCN was received, the case was fixed for hearing on March 9, 2016, however, the respondent through letter dated March 7, 2016 requested for adjournment. Another hearing in the matter was fixed on March 31, 2016 and the respondent was represented by Mr. Jawad Ahmed Rana and Syed Muhammad Ali, the authorized representatives. With reference to the contents of the SCN, they stated as under:

- We started audit of the Company from the year 2013 and previously another firm was appointed as auditor of the Company.
- We evaluated the risk assessment and the management's representation that the lease agreement was to be renewed in the year 2015.

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- The Company had plans to switch over the business to readymade garments.
- The matter regarding going concern uncertainties will be addressed in Accounts for the year 2016 appropriately.

However, the representatives were apprised of the fact that the Company has effectively abandoned its main business and had sold of the plant and machinery and has resorted to rentals from leasing out of its premises. Therefore, there was a material uncertainty about the Company's ability to continue as a going concern and the Auditor was required to appropriately highlight that in the report to members in terms of ISA 570. They admitted that the matter should have been highlighted in the Auditor's report to members. The representatives ensured that the going concern issue will be appropriately highlighted in the Auditor's report to members on the Accounts for the year 2016. Based on their submissions they requested for a lenient view in the matter.

5. Before proceeding further, it is necessary to advert to the relevant provisions of the Ordinance, the Rules and ISAs.

Section 255 of the Ordinance prescribes powers and duties of the auditors and sub-section (3) of section 255 prescribes requirements, manner and content of auditors' report on the Accounts.

Rule 17 (A) of the Companies (General Provisions and Forms) Rules, 1985 (the "Rules") states that the auditors' report on the accounts and books of accounts and balance-sheet and profit and loss account of a company required by section 255 of the Ordinance shall be on a prescribed format contained in FORM 35-A, and the prescribed format, inter alia, contains the statement by the auditor that "*we conducted our audit in accordance with the auditing standards as applicable in Pakistan*"

ISA 570 – Going Concern

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.*

10. *When performing risk assessment procedures as required by ISA 315 the auditor shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.*

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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)
16. If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional audit procedures, including consideration of mitigating factors.
17. The auditor shall 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.
18. If the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:
- (a) Adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and
 - (b) Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business. (Ref: Para. A20)
19. If adequate disclosure is made in the financial statements, the auditor shall express an unmodified opinion and include an Emphasis of Matter paragraph in the auditor's report to:
- (a) Highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern; and
 - (b) Draw attention to the note in the financial statements that discloses the matters set out in paragraph 18. (Ref: Para. A21-A22)
20. If adequate disclosure is not made in the financial statements, the auditor shall express a qualified opinion or adverse opinion, as appropriate, in accordance with ISA 705. The auditor shall state in the auditor's report that there is a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern. (Ref: Para. A23-A24)
21. If the financial statements have been prepared on a going concern basis but, in the auditor's judgment, management's use of the going concern assumption in the financial statements is inappropriate, the auditor shall express an adverse opinion. (Ref: Para. A25-A26)
22. If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor shall consider the implications for the auditor's report. (Ref: Para. A27)

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ISA 705 - Modifications to the Opinion in the Independent Auditor's Report

A2. ISA 700 requires the auditor, in order to form an opinion on the financial statements, to conclude as to whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement. This conclusion takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements in accordance with ISA 450.5

6. The auditor shall modify the opinion in the auditor's report when:

- (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or (Ref: Para. A2–A7)*
- (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. (Ref: Para. A8–A12)“*

Para 7, 8, 9 and 10 of the ISA 705 prescribe the criteria for determining the type of modification to the auditor's opinion.

Section 260 of the Ordinance states as under:

“(1) If any auditor's report is made, or any document of the company is signed or authenticated otherwise than in conformity with the requirements of section 157, section 255 or section 257 or is otherwise untrue or fails to bring out material facts about the affairs of the company or matters to which it purports to relate, the auditor concerned and the person, if any, other than the auditor who signs the report or signs or authenticates the document, and in the case of a firm all partners of the firm, shall, if the default is wilful, be punishable with fine which may extend to one hundred thousand rupees.

(2) If the auditor's report to which sub-section (1) applies is made with the intent to profit such auditor or any other person or to put another person to a disadvantage or loss or for a material consideration, the auditor shall, in addition to the penalty provided by that sub-section, be punishable with imprisonment for a term which may extend to one year and with fine which may extend to one hundred thousand rupees.”

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).

6. I have analyzed the facts of the case, the relevant provisions of the Ordinance, the Rules, requirements of ISAs and the arguments put forth by the respondent. My observations in this regard are as under:

- a) A statutory auditor is bound to follow the requirements prescribed by the Ordinance, the Rules and the ISAs and has to express an opinion remaining within the confines set by



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them. The ISAs contain objectives, requirements and application and other explanatory material that are designed to support the auditor in obtaining reasonable assurance. The ISAs require that the auditor exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit. In terms of the Ordinance and the ISAs it is auditor's duty to identify and assess risks of material misstatements, obtain sufficient appropriate evidence and form an opinion based on conclusions drawn from the audit evidence.

- b) The respondent gave an unmodified opinion in his audit report on Accounts 2014 despite the fact that there was material uncertainty about Company's ability to continue as a going concern, as its main business was suspended, the entire plant and machinery was disposed of and it sustained a loss of Rs1.117 million. The Company resorted to rental from leasing out of its premises and was generating meagre revenues not sufficient to cover the expenses. Moreover, the expiry date of lease agreement was approaching and it was not renewed as on the date of authorization for issuance of Accounts. The management did not make appropriate disclosure regarding going concern uncertainties. The respondent was, therefore, required to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in 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.
- c) The Accounts do not contain any disclosure regarding doubts about the Company's ability to continue as a going concern or any assessment by the management in this regard based on which the Accounts were prepared on going concern basis. Therefore, the respondent was required to render, at least, a qualified opinion in line with requirements of para 20 of the ISA 570 which requires that if adequate disclosure is not made in the financial statements regarding the going concern uncertainties, the auditor shall express a qualified opinion or adverse opinion, as appropriate, in accordance with ISA 705. Moreover, the auditor is required to state in the report that there is a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern. The respondent did not fulfill any of these requirements in his report on the Accounts.
- d) In view of the aforesaid, I am of the considered view that the respondent has failed to discharge his duties in this regard as he did not appropriately modify his opinion in his

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report on Accounts 2014. In fact the respondent in his report did not even add any emphasis of matter paragraph, which is the bare minimum requirement even if adequate disclosure has been made in the financial statements regarding material uncertainties that may cast significant doubts about the going concern ability of an entity.

7. Before proceeding to decide the matter, I deem it necessary to make some observations on the role of auditor of a company. The duties and responsibilities of an auditor appointed by the shareholders under the law can best be understood if we look at the place of an auditor in the scheme of the company law. The capital required for the business of a company is contributed by its shareholders who may not necessarily be the persons managing the company. They elect directors and entrust the affairs of the company to them with responsibility that they will manage the company to shareholders' benefits. There is no such arrangement in place whereby the shareholders can have an independent view as to how the directors have managed the affairs of the company. The financial statements are the most important source of reliable information for the shareholders who make their investment decision based on such information. The financial statements not only show the financial position and performance of the company but also show the results of management's stewardship of resources entrusted to it. Therefore, correct reporting in the financial statements in line with applicable financial reporting framework is of utmost importance. The law, therefore, recognizing this situation, has provided for the appointment of auditors who shall be responsible to audit the books of account, documents and financial statements required by the law and make out a report on them at the end of each year. This being the only safeguard provided by law to the shareholders to ensure accountability of the management, put the auditors to a high level of accountability in case they fail to make out a report in accordance with the legal requirements. For these reasons, it is of utmost importance for the auditors to exercise due care and diligence in performing their duties and discharging their responsibilities and maintain a high level of trust and integrity at their end.

8. For the foregoing reasons, I am of the view that the respondent in his audit reports to members on Company's Accounts for the years ended June 30, 2014 failed to appropriately modify his opinion and, hence, has not discharged his duties under the law. Therefore, the respondent is liable to penalty under section 260 of the Ordinance. However, considering the acquiescence of default by the respondent and assurance for future compliance, instead of imposing maximum



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fine, I hereby impose a fine of Rs.5,000/- (Rupees five thousand only) on the respondent under sub- section (1) of section 260 of the Ordinance.

The respondent is directed to deposit the aforesaid fine 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. The respondent must furnish receipted vouchers for information and record, failing which proceedings under the Land Revenue Act, 1967 will be initiated that may result in the attachment and sale of movable and immovable property.

Abid Hussain
Executive Director (CSD)

Announced:
April 15, 2016
Islamabad