



Corporate Supervision Department
Company Law Division

Before Abid Hussain – Executive Director (Corporate Supervision Department)

In the matter of

**Amin Mudassar & Co., Chartered Accountants- Auditors of Sheikh Wahiduddin Industries
(Private) Limited**

Number and date of notice: CSD/ARN/272/2016-2971, dated February 1, 2016
Date of hearing: April 18, 2016
Present: Mr. Muhammad Daoud, FCA, authorized representative

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. Muhammad Amin (the "respondent"), audit engagement partner of Amin Mudassar & Co., Chartered Accountants (the "Auditor") in respect of audit of annual financial statements (the "Accounts") of Sheikh Wahiduddin Industries (Private) Limited (the "Company") for the years ended June 30, 2014 and 2015. The proceedings were initiated through show cause notice ("SCN") dated February 1, 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 years ended June 30, 2014 and 2015 revealed that the Company reported nil sales for those years, the business of the Company had remained suspended, its operating cash flows were negative and its equity was deteriorated due to losses, as tabulated below:

(Amounts in Rs)

	2015	2014	2013
Shareholders' equity	2,409,128	2,876,790	3,283,186
Accumulated Loss	(17,449,932)	(16,982,270)	(16,575,874)
Loss for the year	(467,662)	(406,396)	(321,165)
Net Cash Flows from Operations	(479,962)	(415,796)	(327,165)

Note 1.2 to the Accounts 2015 of the Company stated as under:

"The company had ceased its operations due to unfavourable market conditions. These financial statements, however, did not include any adjustment relating to the recoverability and classification of recorded assets and liabilities that might be necessary should the company be unable to recommence its operations. However, management of the company has no intention to wind up of the company."



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Moreover, the directors' report attached to the Accounts 2014 and 2015 stated that *the factory had not been in operation and closed down since last few years.*

Due to the aforementioned circumstances during the years 2014 and 2015, material uncertainty existed on a continuing basis regarding the Company's ability to continue as a going concern. However, the management did not give adequate disclosures regarding the material uncertainty about Company's ability to continue as a going concern and despite suspended operations for last few years, did not give any disclosure regarding the basis of using going concern assumption in preparation of Accounts.

3. The Auditor in its report to members on the Accounts 2014 and 2015, had given the following qualification with regard to non-charging of depreciation on 'property, plant and equipment':

"The Company has not charged the depreciation on 'property plant and equipment'. Had the depreciation been charged, the loss for the year and accumulated loss would have been higher by Rs69,632 and Rs1,671,816, respectively."

Furthermore, the Auditor in his report on the Accounts 2014 and 2015 added only the following emphasis of matter paragraph:

"The Company had ceased its operations and has accumulated loss of Rs17.45 million (2014: Rs16.982 million). These factors may cast doubt on Company's ability to continue as 'going concern'. However, the financial statements have been prepared on 'going concern' basis. Our report is not qualified in respect of the above matter." (Emphasis added)

4. The auditors conduct audit of the company and make a report thereon within the confines of the Ordinance. The Ordinance in turn requires him to conduct audit among others as per the requirement of International Standard on Auditing ("ISA"). In view of the material uncertainty regarding Company's ability to continue as a going concern and inadequate disclosures given in the Accounts 2014 and 2015 by the management in this regard, the Auditor was required to either express a qualified opinion or adverse opinion, as appropriate in accordance with ISA 705.

5. Due to the aforementioned facts, the Auditors' reports on the Account 2014 and 2015 of the Company were, prima facie, not in accordance with the requirements of section 255 of the



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Ordinance and ISAs, as those were not appropriately modified. Hence the Auditor, prima facie, failed to bring out material facts about the affairs of the Company making him liable for action under section 260 of the Ordinance. Consequently, the SCN was issued to the respondent who was the audit engagement partner of the Auditor. In terms of the SCN he was called upon to show cause in writing within fourteen days as to why penal action may not be taken against him for the alleged violations.

6. In response to the SCN, the respondent through letter dated February 10, 2016 requested to provide an opportunity to appear in person to clarify his position. The case was fixed for hearing on April 7, 2016, however, no one appeared on the due date. Another hearing in the matter was fixed on April 18, 2016 and Mr. Muhammad Daoud, FCA, the authorized representative of the respondent, appeared before the undersigned on the due date and made the following submissions:

- The Company is a closely held private limited company with only two shareholders.
- The operations of the Company are closed for more than seven years.
- In future, due care will be exercised to appropriately modify the auditors' report in line with the ISAs.
- The matter will be taken up with the management to consider the possibility to prepare the Accounts on net realizable value basis and / or adequate disclosure, in case there is no improvement regarding going concern, as per applicable ISAs.

It was further stated by the authorized representative that considering the fact that it is a small company a lenient view may be taken.

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

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



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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.

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)



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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)

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)"

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

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"

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



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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).

8. 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 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 did not modify his opinion with regard to going concern uncertainty and instead only added an emphasis of matter paragraph in his audit report on Accounts 2014 and 2015, despite the fact that there was material uncertainty about Company's ability to continue as a going concern and the management did not give adequate disclosure regarding going concern uncertainties arising out of closure of the Company's core business for many year. Despite its closed operations and no sales for last many years, no disclosure was given regarding the basis of using going concern assumption in preparation of Accounts by the management. Moreover, the Accounts did not include any adjustments relating to recoverability and reclassification of assets and liabilities that might be necessary should the Company be unable to recommence its operations. 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



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the financial statements and to conclude whether there was a material uncertainty about the entity's ability to continue as a going concern. The respondent has failed to discharge his duties in this regard. It appears that he has not appropriately carried out an assessment of the use of going concern and resultantly failed to appropriate modify his opinion in his report on Accounts 2014 and 2015 with regard to going concern.

- c) The respective Accounts did not include adequate disclosure regarding going concern uncertainties and based on this discrepancy alone, the Auditor, at the minimum, was required to either express an adverse opinion or a qualified opinion, as per criteria set forth by para 20 of IAS 570, but he resorted to adding only an emphasis of matter paragraph. This clearly establishes that he failed to discharge his duties appropriately.
- d) The going concern issue, inadequate disclosure and not including any adjustments relating to recoverability and reclassification of assets and liabilities in the Accounts in this regard coupled with non-charging of depreciation on fixed assets, had material and pervasive effect on the Accounts of the Company. In view of these facts, an adverse opinion in line with requirements of para 21 of ISA 570 was warranted. However, the respondent only qualified his opinion with regard to non-charging of depreciation and only added emphasis of matter paragraph regarding going concern uncertainties. Therefore, he has failed to discharge his duties appropriately.

9. 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



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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.

10. 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 and 2015 failed to appropriately modify his opinion and, hence, has not discharged his duties under the law. However, I take into account the acquiescence of default by the respondent, his assurance for future compliance and the fact that the Company is a closely held private limited concern with only two shareholders. Therefore, instead of imposing fine in exercise of powers conferred by section 260 of the Ordinance, I hereby conclude the proceedings with a stern warning to the respondent to be careful in future and discharge his duties diligently as per applicable laws and ISAs.

Abid Hussain
Executive Director (CSD)

Announced:

May 2, 2016
Islamabad