



Corporate Supervision Department
Company Law Division

Before Abid Hussain – Executive Director (CSD)

In the matter of

**Mr. Mahmood Akhtar, Audit Engagement Partner of M. Akhtar & Co., Chartered Accountants -
Auditor of Dadabhoy Cement Industries Limited**

Number and date of notice: CSD/ARN/226/2015-3536, dated March 7, 2016
Date of hearings: May 18, 2016
Present: Mr. Mahmood Akhtar, the Respondent

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. Mahmood Akhtar, (the "respondent"), audit engagement partner of M. Akhtar & Co., Chartered Accountants (the "Auditor") who audited the annual financial statements (the "Accounts") of Dadabhoy Cement Industries Limited (the "Company") for the years ended June 30, 2010 to June 30, 2015. The proceedings were initiated through show cause notice ("SCN") dated March 7, 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, 2010 to 2015, filed with the Commission under section 233 of the Ordinance revealed the following observations:

- i. Operations of the Company are closed since August 2008 and the company has been reporting nil sales. No concrete plan or progress regarding revival given. The Company has not given adequate disclosures to mitigate the uncertainty about the Company's ability to continue as a going concern.
- ii. The Company has total assets of Rs.3.58 billion including 'plant & machinery' of Rs.2.67 billion that constitutes 74.5% of total assets. The Company has not charged depreciation on the plant and machinery since 2011. Last revaluation of assets was carried out in 2009 and since then assets have neither been revalued nor has any impairment been charged since then, against the requirements of International Financial Reporting Standards



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("IFRS") that include International Accounting Standards ("IAS"). The Company has written-off Rs.19.17 million in 'advances, deposits & other receivables' in 2014 and has been writing-off the 'stores & stocks' with following amounts:

(Rs. in millions)

Year	2010	2011	2012	2013	2014	2015
Amounts written off	24.77	128.28	-	97.96	28.5	-

- iii. The Company has not given disclosure of the number of employees as at the year end and average number of employees during the years 2014 and 2015 as per requirement of clause-2(H) of Part-III of the Fourth Schedule to the Ordinance.
- iv. The net equity of the Company has reduced from Rs.503.72 million in 2010 to Rs.152.48 million in 2015. Had the Company correctly charged the depreciation on 'plant & machinery', the net equity would have further decreased.
- v. The Company had recognized the 'deferred income' of Rs.138 million under 'trade & other payables' in 2008, as a reduction in banks' loan (note 12.1.3). The Company has not recognized it as income since 2008 in Profit and Loss Account. The Company has also disclosed in note 12.1.4 that *further to the above note, the management has informed us that the above amount of decree has been lapsed / time barred, hence, this amount stands Nil*". The above disclosure by the Company is incommensurate with the fact that the liability is still disclosed under current liabilities as 'deferred income' and has not been recognized in 'Profit and Loss Account'.
- vi. The Company has disclosed interest free loan from directors of Rs.178.72 million at historical cost instead of amortized cost against the requirements of IAS 39. The amount of the impact on profit and loss account has not been determined by the Company.
- vii. Since 2009 the Company is stated to be in negotiations with National Bank of Pakistan ("NBP") for settlement of outstanding loan of Rs.600 million. The auditor in its report on Account 2009 had stated that as per the bank's letter the said loan is immediately payable. The Company has not been recognizing any interest/markup on the outstanding amount and it is still categorized as long term liability against the requirement of para 69 of IAS 1 which requires a liability to be classified as current if the entity does not have unconditional right to defer settlement for at least twelve months. The Company in 2010 to 2015 accounts has stated that *it was agreed that the terms and conditions of the understanding between the parties for the settlement of the entire liability cannot be reduced in black and white due to legal binding*. The auditor in the subsequent Accounts has not highlighted the, prima facie, wrong classification as current liability.
- viii. The Company has disclosed investment of Rs.2.42 million using equity method (note 3.10) as on June 30, 2015 (note 5) in its associated listed company, Dadabhoy Sack Limited (the "DSL"), which has ceased operations in 2009. The Company had not recognized the share



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of loss in the year 2010 and since 2011 despite the DSL being in loss, in contravention with requirements of IAS 27.

- ix. The Company has an investment of Rs.205 million at cost in its subsidiary, *Dadabhoj Energy Supply Company Limited ("DESCL")*, an unlisted company which is closed since 2009. As per note-3.8, the Company reviews the carrying value of assets at each balance sheet date to determine any indication of impairment and if such indication exists, the impairment loss is recognized. The *break-up value* of the DESCL's shares was Rs.7.30 (as per available accounts of DESCL for June 30, 2013) reflecting an impairment of Rs.2.7 per share aggregating to Rs.55.19 million, which has not been recognized.

3. In view of the aforesaid observations and non-compliances in preparation of Accounts, the Accounts 2010 through to 2015 have been, prima facie, misstated and the impact of misstatement also appears to be material. The Auditor having audited the Accounts 2010 through to 2015, gave unmodified opinions in the reports to members on respective Accounts 2011 through to 2015 with respect to the issues highlighted above and only qualified his report to members on the Accounts 2010 with regard to going concern issue. The Auditor in his reports on Accounts 2011 to 2015 has only made his report subject to note 2 to the respective Accounts, which only contain a generalized statement that the directors have taken several positive steps to restart production including negotiations with lenders of long term finances. However, there has been no disclosure in the Accounts regarding any concrete future plan or progress made for revival over the years and the factors mitigating the material uncertainty about the Company's ability to continue as a going concern. The respondent being the engagement partner of the Auditor, prima facie, failed to appropriately modify his opinions, in his respective reports to members on the Accounts 2011 through to 2015, with regards to the material misstatements arising out of the aforementioned non-compliances of IAS and has given only qualified report on the Accounts 2010 with regard to going concern issue while other issues have not been highlighted. Due to the respondent's, prima facie, failure to modify his opinion in the reports on Accounts 2010 through to 2015 for the misstatements arising out of non-compliance with IAS and non-disclosures of material uncertainties about the Company's ability to continue as a going concern, the audit reports on the respective Accounts were not in accordance with the requirements of section 255 of the Ordinance and International Standards on Auditing ("ISAs") making him liable for action under section 260 of the Ordinance. Consequently, the SCN was issued to the respondent calling upon him to explain as to why penal action may not be taken against him under section 260 of the Ordinance.



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4. In response to the SCN, the respondent after seeking an extension through letter dated March 18, 2016, submitted reply dated March 31, 2016. A brief of contents of the reply relevant to the contents of the SCN is given below:

- i. Operations of the Company have been closed since August 2008 and sale/production was shown according to the actual results derived. As regards positive steps taken by the Company's management for its revival, the Company's fixed assets are mortgaged with bankers and if disposed of by them it would have adverse effect. Otherwise there is no doubt about positive steps taken by the management.
- ii. The plant & machinery and quarry equipment were not liable to be depreciated owing to no production, as per Company's Policy disclosed at note 3.6 to the Accounts. Please also refer Para 55 of IAS 16. Revaluation of Fixed Assets will be made as deemed necessary by the management, to give effect to the impairment of fixed assets.
- iii. Amount of remuneration to chief executive, directors and Executives have been shown as Nil and status of their strength is also given. Salaries and allowances to non-executive staff were shown.
- iv. There will be no adverse effect to the Equity as depreciation in question has been correctly/ adequately charged.
- v. The deferred income arisen out of restructuring of long term loans from banks and has been shown unadjusted owing to final decision pending with the Court. As stated in 12.1.4 that decree to recover the amount has been lapsed but court's final decision as to settlement of Rs.600 million is still awaited. Hence adjustment in this regard can't be made in the accounts and preferred to keep amount of deferred income as it is. Please refer Note 12.1.2 of the Accounts 2015.
- vi. The loan taken from directors was for disbursement of expenses. It does not attract impairment/amortization clause of IAS 39. If the Company management had foregone their liability with no claim at the time of final settlement, then it will be considered accordingly.
- vii. Loan payable to NBP is subject to court's final decision which is pending and mark up, if any, will be accounted for accordingly. The Company had requested the bank for further



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rescheduling if payment was desired despite time barred status, as per management's perception. The deferred income of Rs.138.713 million had also arisen due to charging of markup in the past which remained disputed. It will be reclassified if deemed appropriate on final decision of court and the requested restructuring arrangement with the bank.

- viii. DSL is an associated company of the Company and loss is not material when compared to the Company's holding of around 7% in DSL. The Company is planning to transfer this investment to interested director.
- ix. Loss of DESCL is taken care of when preparing consolidated financial statements, as the Company has major shareholding.

The respondent further stated in the reply that no concealment/misstatement as to going concern was made and no amount was omitted. In respect of management's efforts for revival, the respondent provided a copy of intent letter dated March 22, 2016 from Digital World International Co., Saudi Arabia, whereby it agreed to provide consultation for arranging financing and upgrading/refurbishment of the Company's plant. Based on the above submissions the respondent requested for a lenient view. The case was fixed for hearing on May 18, 2016 and Mr. Mahmood Akhtar appeared before the undersigned on due date. He mainly reiterated his earlier stance as per the written submissions and requested for a lenient view while deciding the case.

5. Before proceeding further, it is necessary to advert to the following relevant provisions of the Ordinance, the Rules, IFRS and ISAs regarding auditor's responsibilities:

IAS 1 – Presentation of Financial Statements

69. An entity shall classify a liability as current when:
 - (a) it expects to settle the liability in its normal operating cycle;
 - (b) it holds the liability primarily for the purpose of trading;
 - (c) the liability is due to be settled within twelve months after the reporting period; or
 - (d) the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. **(Emphasis added)**

IAS 16 – Property Plant and Equipment

Revaluation model

31. After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated



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impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

63. To determine whether an item of property, plant and equipment is impaired, an entity applies IAS 36 - Impairment of Assets. That Standard explains how an entity reviews the carrying amount of its assets, how it determines the recoverable amount of an asset, and when it recognizes, or reverses the recognition of, an impairment loss.

IAS 28- Investments in Associates

11. Under the equity method, the investment in an associate is initially recognized at cost and the carrying amount is increased or decreased to recognize the investor's share of the profit or loss of the investee after the date of acquisition. The investor's share of the profit or loss of the investee is recognized in the investor's profit or loss. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's other comprehensive income. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognised in other comprehensive income of the investor (see IAS 1 Presentation of Financial Statements, as revised in 2007).

IAS 36 – Impairment of Assets

9. An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.

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.

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)



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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)

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

A4. In relation to the appropriateness of the accounting policies management has selected, material misstatements of the financial statements may arise when:



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- (a) *The selected accounting policies are not consistent with the applicable financial reporting framework; or*
- (b) *The financial statements, including the related notes, do not represent the underlying transactions and events in a manner that achieves fair presentation*

A6. *In relation to the application of the selected accounting policies, material misstatements of the financial statements may arise:*

- (a) *When management has not applied the selected accounting policies consistently with the financial reporting framework, including when management has not applied the selected accounting policies consistently between periods or to similar transactions and events (consistency in application); or*
- (b) *Due to the method of application of the selected accounting policies (such as an unintentional error in application)*

A7. *In relation to the appropriateness or adequacy of disclosures in the financial statements, material misstatements of the financial statements may arise when:*

- (a) *The financial statements do not include all of the disclosures required by the applicable financial reporting framework;*
- (b) *The disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework; or*
- (c) *The financial statements do not provide the disclosures necessary to achieve fair presentation. (emphasis added)*

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.

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 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.

Section 260 of the Ordinance states as under:



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“(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 the Executive Director (Corporate Supervision Department).

6. I have analyzed the facts of the case, relevant provisions of the Ordinance and the arguments put forth by the respondents and my observations are as under:

- i. The fact that the Company’s operations have been closed since 2009 with no sale, substantial continuing operating losses, accumulated losses amounting to Rs.863.104 million as of June 30, 2015, current liabilities exceeding current assets and negative operating cash flows, raises serious doubts about the Company’s ability to continue as a going concern. Since then the directors, instead of giving a concrete revival plan and progress in this regard, have relied upon giving mere statements that several positive steps have been taken to restart production including negotiations with lenders of long term finances. The management neither gave appropriate disclosure regarding going concern uncertainties nor did it make adequate disclosures to mitigate the uncertainty about the Company’s ability to continue as a going concern in the Accounts since 2009. In view of existence of material uncertainty about the Company’s’ ability to continue as a going concern the Auditor was required to obtain sufficient appropriate audit evidence about the appropriateness of management’s use of the going concern assumption in



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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 failed to do so and in disregard of the aforesaid circumstances, has been giving unmodified opinions on the going concern issue in the reports to members on Accounts 2011 through to 2015. The Auditor has rather resorted to giving a mere reference to note 2. The said note 2 to the respective accounts does not contain any disclosure regarding the material uncertainty about the Company's ability to continue as a going concern. The Auditor 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 respective Accounts since the year 2011 through to 2015. Preparation of financial statements is responsibility of the management and it is auditor's responsibility to express an independent opinion on the financial statements. Where an auditor is required to specifically give an opinion, he has to render a specific opinion and merely giving a reference to disclosure of certain facts in the Accounts does not absolve the auditor of his responsibility to express opinion as per applicable law and ISAs. The respondent has failed to clarify his position with regard to this issue.

- ii. With regard to non-charging of depreciation and impairment on 'plant and machinery' and 'quarry equipment', it has been stated by the respondent that as per Company's policy depreciation on these assets is charged using unit of production method and since there has been no production, the depreciation has not been charged in line with para 55 of IAS 16. However, the respondent has failed to provide any justification for not charging impairment since the year 2009 despite the fact that these assets remained idle since then. The 'plant & machinery' of Rs.2.67 billion at their revalued amounts constitute 74.5% of Company's total assets. Since the year 2009, no revaluation of these assets has been carried out and no impairment been charged. In terms of para 31 and 63 of IAS 16 read with para



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9 of IAS 36, 'plant and equipment' was required to be carried at the fair value less subsequent accumulated impairment losses, even if depreciation was nil as per usage method. IAS 16 specifically requires that revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period. Moreover IAS 16 requires applying IAS 36 to determine impairment of these assets. IAS 36 requires an entity to assess at the end of each reporting period whether there is any indication that an asset may be impaired and also requires estimating the recoverable amount of the asset. Para 12 of IAS 36 contains a list of non-exhaustive list of external and internal sources of information for indication of impairment. It specifically mentions the asset becoming idle as one of such indications. Despite the fact that the plant and machinery has been idle for six years, the management did not get it revalued or assessed it for impairment even though it was probable that these assets could be significantly impaired over this long period of time. The Auditor in his report to members on respective Accounts failed to highlight this non-compliance with IFRS and its impact on the fair presentation of the Accounts. The Auditors' report is also silent about writing off of the 'advances, deposits & other receivables' in 2014 and 'stores & stocks' from 2010 to 2014.

- iii. Mandatory disclosure of the number of employees as at the year end and average number of employees during the years 2014 and 2015 in terms of clause-2(H) of Part-III of the Fourth Schedule to the Ordinance were missing from the Accounts, and the Auditors did not highlight this non-compliance. These are specifically required disclosures and the respondent's referral to other general disclosures in the Accounts does not justify this non-compliance.
- iv. The net equity of the Company has reduced from Rs.503.72 million in 2010 to Rs.152.48 million in 2015. Even in the absence of any depreciation charge in line with the Company's policy, it was mandatory to assess the assets for impairment. Given the fact that the assets have been idle since 2009, an impairment charge would have substantially reduced the value of assets and the equity of the Company.



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- v. With regard to the disclosed 'deferred income' of Rs.138 million under 'trade & other payables' in 2008 and not crediting it to profit and loss account, it has been stated by the respondent that it arose out of restructuring of long term loans from banks and has been shown unadjusted owing to decision pending with the Court. In connection with this, it must be noted that recording a 'deferred income' under current liabilities (trades and other payables) does not appear to be consistent with the accounting norms and may cause confusion, given the fact that disclosure given by the management is incomplete. Moreover, it is also absurd that the Company has disclosed the amount of Rs.600 million as a Long Term Loan which is under negotiations for settlement and on which the Company does not have unconditional right to defer payment beyond 12 months period after the reporting date. However, the amount of Rs.138 million which was actually a reduction in the above Long Term Loan subsequent to negotiations with banks, as per Company's disclosure, has been shown under current liabilities. The Company has also disclosed in note 12.1.4 that *further to the above note, the management has informed us that the above amount of decree has been lapsed / time barred, hence, this amount stands Nil*". The above disclosure by the Company is incommensurate with the fact that the liability is still disclosed as under current liabilities as 'deferred income' and has not been recognized in 'Profit and Loss Account'. The above stated facts show inconsistent disclosure by the management, but the Auditor did not highlight it in his reports on respect Accounts.
- vi. With regard to disclosure of interest free loan from directors of Rs.178.72 million at historical cost instead of amortized cost as per IAS 39, it has been stated by the respondent that the loan was for disbursement of expenses and does not attract impairment/amortization clause of IAS 39. The respondent's plea is not tenable in view of requirements of para 46 of IAS 39 which requires that loans and receivables shall be measured at amortized cost using the effective interest method. It is the responsibility of the management of the Company to ensure that loans obtained from directors are based on agreements in writing that include the terms and condition of such loans so that the liabilities of the Company could be appropriately determined and accounting for in line with applicable IFRS. The Auditor failed to highlight the incorrect accounting treatment and disclosure of the directors' loan in contravention with the IFRS.



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- vii. In respect of classification of outstanding loan of Rs600 million from NBP, as a long term loan instead of current liabilities, it has been stated by the respondent that the loan payable to NBP is subject to court's pending final decision and that it will be reclassified if deemed appropriate on final decision of court. It must be noted that in terms of IAS 1, unless a Company has unconditional right to defer payment of a liability beyond a period of twelve months after the reporting date, it has to classify such liability as a current liability instead of long term liability. Since, in the case of loan payable to NBP, even though the matter is in court, the Company does not have unconditional right to defer payment beyond 12 months, it should have classified the liability as current. This fact was highlighted by the Auditor in its report on Account 2009 that as per the bank's letter the said loan is immediately payable. However, afterwards, the Auditor in his subsequent reports on respective Accounts failed to highlight the aforesaid wrong classification of NBP Loan as current liability in violation of the IFRS.
- viii. With regard to non-recognition of share of loss on Company's investment of Rs.2.42 million in DSL under equity method, the respondent has pleaded that the amount of Company's share of DSL's loss was not material given 7% shareholding in DSL and that the Company is planning to transfer this investment to interested director. The Auditor failed to highlight this non-compliance with requirements of IAS 27. The respondent has given no tenable clarification for not highlighting the aforesaid incorrect accounting treatment of Company's investment in DSL in contravention with requirements of IFRS. IAS 28 requires that the investment in an associate under equity method is initially recognized at cost and the carrying amount is increased or decreased to recognize the investor's share in the profit or loss of the investee after the date of acquisition. Moreover, investor's share of profit / loss of the associate has to be recognized in its own profit and loss.
- ix. In contravention with the requirements of IAS 39 and its own stated policy, the Company did not recognize the impairment loss on its substantial investment of Rs.205 million at cost in its subsidiary, *DESCL*, which is closed since 2009. As of June 30, 2013, the break-up



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value of the DESCL's shares was Rs.7.30. It was a clear indication of an impairment of at least Rs.2.7 per share aggregating to Rs.55.19 million. However, the same has not been recognized in Company's Accounts in violation of its own policy and the IFRS. The Auditor failed to highlight this non-compliance with IFRS in his report. The which has not been recognized

- x. The ultimate responsibility of preparing the financial statements in accordance with the Ordinance and IFRS including the IASs rests with directors. It is the duty of the statutory auditor of a company to express an independent opinion including, inter alia, the opinion as to whether or not the financial statements confirm with the approved accounting standards that comprise the IFRS, IAS. The Ordinance and IFRS require that financial statements should present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses. This necessitates adequate disclosure and full compliance with all applicable IFRSs. 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 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. Para 8 of ISA 200 clearly states that the form of opinion expressed by the auditor will depend upon the applicable financial reporting framework and any applicable law or regulation. (Ref: Para. A12-A13).
- xi. The overall impact of non-compliances taken together with the inappropriate use of going concern assumption, not charging impairment on assets, non-amortization of loans and other non-compliances with IFRS was material and potentially pervasive. Moreover, in view of inappropriate use of going concern assumption and lack of disclosure regarding



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material uncertainty about going concern, an adverse opinion was imperative. Under the circumstances, the statement of compliance wherein the Company has stated that the Accounts have been prepared in accordance with approved accounting standards, as applicable in Pakistan is also incorrect. Taken together, the non-compliances of IFRS by the Company in preparation of its Accounts, as highlighted in the preceding paragraphs, resulted in material misstatements in the respective Accounts. It was responsibility of the respondent to appropriately modify his opinion in reports to members on respective Accounts, to discharge his duties under the Ordinance, the Rules and ISAs. However, the respondent failed to appropriately modify his reports to bring out the aforesaid instances of non-compliances. It must be kept in mind that the financial statements are used by a variety of users including the shareholders, bankers, financiers, investors, potential investors and general public etc. The audited financial statements along with auditor's report are the most important source of financial information for the users who rely on the information disclosed therein. Any misstatements or omission of material facts in the financial statements can adversely due to non-compliance with applicable IFRS affect the decisions of the users.

- xii. Section 255 of the Ordinance prescribes powers and duties of the auditors and also sets the format of auditors' report. In terms of section 260 of the Ordinance, it is duty of the auditor to bring out all material facts about affairs of the Company in his report to members. In the instant case, the respondent in his capacity as engagement partner of the Auditor has not discharged his duties as per requirements of the Ordinance, Rules and the ISAs, as explained above. Moreover, it has also been highlighted during the proceedings that the Auditor does not have a satisfactory rating from the Quality Control Review ("QCR") committee of the Institute of Chartered Accountants of Pakistan ("ICAP") and, hence, in terms of the Code of Corporate Governance, was not eligible to be appointed as auditors of a listed company. Although, it is not a subject matter of the instant proceedings, it reflects the casual approach of the respondent towards code of ethics and professional requirements.



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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 in the hope 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 Auditor in his report to members on Company's Accounts for the years ended June 30, 2010 through to June 30, 2015 did not appropriately modify the opinions to highlight the contravention with IFRS and the incorrect accounting treatment adopted by the Company, as highlighted in the preceding paragraphs. Hence, the respondent being the audit engagement partner has not discharged his duties under the law and is liable to penalty under section 260 of the Ordinance. Therefore, in exercise of the powers conferred by section 260 of the Ordinance, I hereby impose a fine of Rs.50,000/- (Rupees fifty thousand only) on the respondent.



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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.

Moreover, the department is advised to review the matter of appointment of the respondent's firm as auditor of a listed company despite not having a satisfactory QCR rating from the ICAP, for appropriate action and/or referring the matter to appropriate forum.

Abid Hussain
Executive Director

Announced:
June 27, 2016
Islamabad