



Corporate Supervision Department  
Company Law Division

Before Abid Hussain – Executive Director (CSD)

*In the matter of*

**Mr. Ahsan Elahi Vohra, Audit Engagement Partner, Naveed Zafar Ashfaq Jaffery & Co.,  
Chartered Accountants - Auditor of Taha Spinning Mills Limited**

Number and date of notice: No. CSD/ARN/20/2015-3133, dated February 4, 2016  
Date of hearings: May 5, 2016  
Present: Mr. Ahsan Elahi Vohra, the Respondent and Mr. Shahid Hussain

**ORDER**

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

This order shall dispose of the proceedings against Mr. Ahsan Elahi Vohra, (the "respondent"), audit engagement partner of Naveed Zafar Ashfaq Jaffery & Co., Chartered Accountants (the "Auditor") who audited the annual financial statements (the "Accounts") of Taha Spinning Mills Limited (the "Company") for the years ended June 30, 2013 and 2014. The proceedings were initiated through show cause notice ("SCN") dated February 4, 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 audited Accounts of the Company for the years ended June 30, 2013 and 2014 and the Auditor's reports attached thereto revealed as under:

- i) During the year 2014, the Company disposed of the land & building having fair value of Rs.93 million for sale consideration of Rs.116.479 million, resulting in profit of Rs.23.479 million (excess of disposal proceeds over carrying amount), the amount that should have been recognized in profit and loss account for the year 2014. However, the Company recognized an amount of Rs.73.857 million in the profit and loss account including the gain (*amount of surplus on revaluation*) of Rs.50.378 million. The amount of Rs.50.378 million should have been transferred directly into 'retained earnings' instead of routing it through profit and loss, as per requirements of International Financial Reporting Standards ("IFRS") including the International Accounting Standards ("IASs"). Resultantly, the profit of the Company for the year 2014 was overstated by Rs.50.378 million.



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ii) As per 'balance sheet' and 'statement of changes in equity' attached to the Accounts 2013, the Company adjusted 'surplus on revaluation of land & building' ("Revaluation Surplus") amounting to Rs.50.378 million against the accumulated losses instead of reporting the same as a separate line item in the balance sheet as per requirements of section 235 and the Fourth Schedule to the Ordinance.

3. Due to incorrect treatment of recognizing the amount of Rs.50.378 million (revaluation surplus) in the profit and loss account for the year 2014, in contravention with the requirements of IAS 16 and IFRS 5, the Accounts 2014 were, prima facie, misstated and the misstatement was material, as substantiated below:

(Amounts in Rs.)

Particulars	Reported Amount	Actual Amount that should have been reported	Difference	Percentage of Misstatement
Profit after tax	72,681,112	22,302,817	50,378,295	126%
EPS	17.95	5.51	12.44	126%

Moreover, the 'surplus on revaluation of land & building' required to be presented as a separate line item in the balance sheet, was not so presented. Resultantly, the presentation of Accounts 2013 was, prima facie, not as per requirements of section 235 and Fourth Schedule to the Ordinance. In view of the applicable provisions of the Ordinance and International Standards on Auditing ("ISAs"), the Auditor was required to:

- (i) Modify his opinion in his report on the Accounts 2014 with regard to, prima facie, misstatement due to wrongly recognizing the gain amounting to Rs.50.378 million in the profit and loss account; and
- (ii) Highlight in his report on Accounts 2013, the non-compliance with requirement of section 235 and the Fourth Schedule to the Ordinance.

The Auditor in his report to members on the Accounts 2014, prima facie, failed to modify his opinion with regard to misstatement in the Accounts as a result of overstatement of profit and also failed to highlight in his report on Accounts 2013, the contravention with the requirements of section 235 and Fourth Schedule to the Ordinance. Therefore, the Auditor's reports on the respective Accounts were, not in accordance with the requirements of section 255 of the Ordinance and ISAs as it, prima facie, failed to bring out material facts about the affairs of the Company



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making the respondent 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.

4. In response to the SCN, the respondent after seeking an extension through letter dated February 17, 2016, submitted reply dated March 8, 2016. A brief of the reply relevant to the contents of the SCN is given below:

- i. Gain on disposal of assets recognized in the profit and loss account amounting to Rs.73,860,785 represents "Realized Gain" on sale of 'Assets Held for Sale' and has been recognized in accordance with provisions of para 24 of IFRS-5. Since the Assets were reclassified as 'Held for Sale', gain has been presented in accordance with IFRS-5 rather than IAS-16. Further, Para (2) of section 235 of the Companies Ordinance, 1984 allows setting off or reducing any deficit or loss, whether past, current or future by the amount of revaluation surplus to the extent actually realized on disposal of revalued assets.
- ii. Company has presented Surplus on Revaluation of Assets as separate line item in Statement of Changes in Equity and it clearly indicates the intent of the management whereas, the aggregate impact of all reserves and surpluses was shown in the balance sheet as a single figure as the related assets were reclassified during the year as 'Held for Sale' and accordingly the nomenclature of surplus on revaluation was changed to "Reserve for Assets Classified as Held for Sale". Such a change is perceived to enhance the understanding of users of financial statements i.e the assets are no more part of Property Plant & Equipment.
- iii. In absence of any revenue generation since the suspension of operations in 2008; disclosure of profit after tax or earning per share become technically meaningless and immaterial things for the users of financial statements. Further, our overall "Adverse Opinion" on the financial statements dilutes the significance of EPS presented by the management of the company.
- iv. We have modified our audit report and expressed an "Adverse Opinion" on the financial statements for the years ended on June 30, 2013 & 2014, respectively, wherein we have explicitly stated under para 1(d) that "*the Financial Statements together with notes*



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*have not been prepared in all material respects as at 30<sup>th</sup> June and of its loss, comprehensive loss, its cash flows and changes in equity for the year then ended in accordance with approved accounting standards as applicable in Pakistan, and do not give the information required by the Companies Ordinance, 1984". Further the adverse opinion has been expressed as per provisions of para A8 of ISA 705.*

v. Complying with the requirements of section 260 of the Ordinance, we have clearly brought material facts about the affairs of the company to the notice of users of the financial statements. Our audit report, with modified adverse opinion clearly indicates that;

- management's going concern assumption is inappropriate;
- company's assets and liabilities should have been stated at their realizable and settlement amounts respectively;
- company's business operations are suspended since 2008;
- company has disposed of its land and building to pay off debts;
- company has not prepared any detailed business plan including future profits and cash flows;
- the foregoing conditions indicate material uncertainty which may cast significant doubt on company's ability to continue as a going concern

The Auditors' intent, professionalism and independence are quite evident from the type of modification to the opinion in accordance with the provisions of ISA 705, whereas, preparation and fair presentation of financial statements still remains the responsibility of the company's management.

Based on the above submissions the respondent requested for a lenient view and to drop further proceedings in the matter.

5. The case was fixed for hearing on April 20, 2016, which after adjournment on request of the respondent was held on May 5, 2016. The respondent himself appeared before the undersigned and mainly reiterated his earlier stance as per the written submissions. He further stated that



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adverse opinion was expressed on the respective Accounts of the Company, therefore, a lenient view may be taken and the proceedings may be concluded without any adverse order.

6. Before proceeding further, it is necessary to advert to the following relevant provisions of the Ordinance, the Rules, IFRS and ISAs:

## IAS 16 – Property Plant and Equipment

41. The revaluation surplus included in equity in respect of an item of property, plant and equipment may be transferred directly to retained earnings when the asset is derecognized. This may involve transferring the whole of the surplus when the asset is retired or disposed of. However, some of the surplus may be transferred as the asset is used by an entity. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. Transfers from revaluation surplus to retained earnings are not made through profit or loss. (Emphasis added)

71. The gain or loss arising from the derecognition of an item of property, plant and equipment shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item. (Emphasis added)

## IFRS 5 – Non-current Assets Held for Sale and Discontinued Operations

24. A gain or loss not previously recognized by the date of the sale of a non-current asset (or disposal group) shall be recognized at the date of derecognition. Requirements relating to derecognition are set out in:

- (a) paragraphs 67–72 of IAS 16 (as revised in 2003) for property, plant and equipment, and
- (b) paragraphs 112–117 of IAS 38 Intangible Assets (as revised in 2004) for intangible assets.



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

**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 235 of the Ordinance provides as under:

*"(1) Where a company revalues its fixed assets, the increase in, or sums added by writing up of, the value of such assets as appearing in the books of accounts of the company shall be transferred to an*



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account to be called "Surplus on Revaluation of Fixed Assets Accounts" and shown in the balance-sheet of the company after Capital and Reserves.

(2) Except and to the extent actually realized on disposal of the assets which are revalued, the surplus on revaluation of fixed assets shall not be applied to set-off or reduce any deficit or loss, whether past, current or future, or in any manner applies, adjusted or treated so as to add to the income, profit or surplus of the company, or utilized directly or indirectly by way of dividend or bonus....." (emphasis added)

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:

"(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).

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

- a) In terms of IAS 16, when an asset is disposed of that has previously been revalued, a profit or loss on disposal is to be calculated as a difference between the carrying amount



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(revalued) of the asset and the proceeds from disposal. This amount is recognized in the profit and loss account. Any remaining surplus on the revaluation reserve which was unrealized also becomes a 'realized' gain and it is transferred directly to retained earnings. It cannot be routed through profit and loss account as the IAS 16 specifically prohibits that. In 2014, the Company disposed of the land & building having carrying amount (fair value) of Rs.93 million for sale proceeds of Rs.116.479 million. It earned a profit of Rs.23.479 million that should have been recognized in the profit and loss accounts in terms of the IAS 16. Instead, the Company recognized an amount of Rs.73.857 million in the profit and loss account including the previously unrealized gain (*amount of surplus on revaluation*) of Rs.50.378 million, which should have been realized by directly transferring it into 'retained earnings'. This accounting treatment adopted by the Company was in clear violation of IAS 16.

- b) The respondent has quoted para 24 of IFRS 5 to justify the recognition of entire amount of Rs.73.857 million in the profit and loss account. It must be noted that para 24 of IFRS 5 requires recognition of gain or loss at the date of sale of a non-current asset (or disposal group) but it does not allow to recognize the gains, which were previously recognized in other comprehensive income or other head of account, in profit or loss account. The aforesaid para is rather relevant in the context that the IFRS 5 requires to carry assets or disposal groups that are classified as held for sale at the lower of carrying amount and fair value less costs to sell. Therefore, in terms of IFRS 5, at the date of sale, gain (or loss) not previously recognized shall be recognized at the date of derecognition. The para 24 also elaborates that requirements relating to derecognition of property, plant and equipment are set out in paragraphs 67-72 of the IAS 16. It clearly means that in respect of disposal of an item of 'property plant and equipment', the requirements of IAS 16 would prevail. These requirements, inter alia, include the accounting treatment for recognizing the gains on disposal and the revaluation surplus. Therefore, the Company's treatment of recognizing the entire amount of gain including remaining amount of revaluation surplus on fixed asset, in the profit and loss account is clearly in violation of the requirements of IFRS. Hence, the profit for the year was overstated and Accounts 2014 were materially misstated. The Auditors failed to modify his opinion with regard to the aforesaid material





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- misstatements caused by the incorrect recognition of entire amount of gain in the profit and loss account.
- c) The respondent's argument that due to no revenue generation since the suspension of operations in 2008; disclosure of profit after tax or earning per share become technically meaningless and immaterial things for the users of financial statements, cannot be used as a justifying ground for failure to highlight a specific non-compliance with IFRS that on its own has resulted in material misstatement in the Accounts. Furthermore, the respondents' argument that overall adverse opinion on the financial statements dilutes the significance of EPS presented by the management of the company, is also not a tenable ground to justify the non-compliance. It is auditors' responsibility to modify the opinion with respect to each non-compliances, which results in material misstatements in the Accounts of a Company. Rendering adverse opinion on overall basis does not absolve the Auditor from his responsibility to appropriately modify the opinion with respect to a specific non-compliance which on its own would result in material misstatements in the financial statements. The circumstances of the case cited by the respondent may be considered as mitigating factor with respect to the default, but the Auditors' responsibility with regard to the failure to modify his report with regard to material misstatements still remains. The spirit of sections 255 and 260 of the Ordinance can only be met if auditor's report is true and is made out strictly in conformity with the prescribed requirements to bring out material facts about the affairs of the company or the matters to which it purports to relate. Therefore, if a specific material non-compliance is not underscored in the auditor's report, the responsibility for the same lies with the auditor.
- d) In the Accounts-2013, surplus on revaluation of fixed assets was netted off with accumulated losses in the 'statement of changes in equity' and was shown under the head of 'accumulated loss' on the face of balance of sheet. This was clearly in violation of the requirements of section 235 of the Ordinance in terms of which specifically requires that the 'Surplus on Revaluation of Fixed Assets Accounts' to be shown in the balance-sheet of the company after Capital and Reserves. Section 235 further prohibits application of the 'Surplus on Revaluation of Fixed Assets Accounts' to set off or reduce any deficit or loss.



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This is also in clear violation of requirements of the Fourth Schedule to the Ordinance which also requires following the requirements of section 235 of the Ordinance with respect to treatment of 'Surplus on Revaluation of Fixed Assets'. The respondent has tried to justify the incorrect presentation of 'Surplus on Revaluation of Fixed Assets' by arguing that it was management's intention to reflect the aggregate impact of all reserves and surpluses which were show shown in the balance sheet as a single figure to enhance the understanding of the users that the assets were no more part of property plant and equipment. However, this argument does not hold ground, because when a provision of the law explicitly requires a specified presentation, the management cannot use its discretion to deviate from such a requirement on any ground. If the management intended to give additional disclosures for better understanding of the users of financial statement, there was no bar in the law to do so. However, specific requirements relating to presentation should not have been contravened under any circumstances.

- e) It is true that the ultimate responsibility of preparing the financial statements in accordance with the Ordinance and IFRS including the IASs rests with directors. If the management fails to prepare financial statements as per requirements of the Ordinance and IFRS, it is auditor's responsibility to highlight each of the non-compliances in his report to members. 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 Company's incorrect treatment of recognizing the entire amount of gain including the amount of surplus on revaluation in the profit and loss account was in clear violation of the requirements of IFRS, as highlighted in the preceding paragraphs. Resultantly, the 'profit for the year' and 'EPS' as disclosed in the Accounts 2014 of the Company were materially misstated. It was responsibility of the respondent to appropriately modify his opinion in respect of the aforesaid material misstatements, to discharge his duties under the Ordinance, the Rules and ISAs. The respondent failed to highlight the aforesaid in his report. However, the respondent issued an overall adverse opinion on the Accounts on other material grounds, which somewhat reduces the impact of the default although it does not absolve the respondent from his responsibility in this regard.



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8. 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.

9. For the foregoing reasons, I am of the view that the Auditor in his report to members on Company's Accounts for the year ended June 30, 2014 did not appropriately modify the opinion to highlight the incorrect accounting treatment adopted by the Company by recognizing the entire amount of gain on disposal of fixed assets in the profit and loss account in contravention with IFRS. Moreover, presentation of 'Surplus on Revaluation on Fixed Assets' in the Accounts for the year ended June 30, 2013 was also not as per requirements of section 235 of the Ordinance and the auditor did not highlight this contravention in his report. Hence, the Auditor's report was not in conformity with the requirements of section 255 and 260 of the Ordinance. However, considering



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the fact that the respondent rendered an overall adverse opinion on the respective Accounts on other material grounds, instead of imposing fine, I take a lenient view and in exercise of power conferred by section 260 of the Ordinance conclude the proceedings against the respondent with a stern warning to him to be careful in future.

**Abid Hussain**  
Executive Director

**Announced:**  
June 15, 2016  
Islamabad