



Corporate Supervision Department  
Company Law Division

Before Abid Hussain – Executive Director (CSD)

*In the matter of*

**CNFA Pakistan Center for Enterprise and Development**

Number and date of notice: CSD/ARN/169/2015-1929, dated June 19, 2015  
Dates of hearings: April 27, 2016  
Present: M. Faheem Akhter, CFO and Syed Murtaza Ali Pirzada

**ORDER**

**UNDER SECTION 492 READ WITH SECTION 476 OF THE COMPANIES ORDINANCE, 1984**

This order shall dispose of the proceedings initiated against all the directors including the chief executive (the "respondents") of CNFA Pakistan Center for Enterprise and Development (the "Company").

1. Syed Abid Ali Bukhari
2. Alan Wilbert Pieper
3. Paul Joseph Sippola
4. Mary Jeanette Beatrice Bright
5. Shamsheer Haider Khan

The proceedings against the respondents were initiated through show cause notice (the "SCN") dated June 19, 2015 under section 492 read with section 476 of the Companies Ordinance, 1984 (the "Ordinance").

2. The brief facts of the case are that examination of annual audited financial statements ("Accounts") for the year ended June 30, 2014 of the Company filed under section 242 of the Ordinance revealed that the following figures were, inter alia, reported therein:

(Amounts in Pak Rupees)		
Particulars	2014	2013
<b>Income and Expenditure Account</b>		
Income	31,133,185	2,935,123
Expenditures	30,865,324	2,428,461
Surplus/(Deficit) for the Year	267,861	506,662
<b>Balance Sheet</b>		
Accrued Expenses	-	2,428,218
Accumulated Fund	1,574,523	1,306,662

The following break up was given in the notes to the Accounts for the aforesaid figures:

Note 6: Accrued Expenses-Salaries Payable	--	2,403,218
Note 7: Income-Salary Receipts	31,133,185	2,935,123
Note 8: Expenditures-Salaries	30,544,624	2,403,218



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In response to the Commission's queries in respect of the Accounts, the Company through Murtaza Pirzada Law Associates furnished reply dated February 23, 2015, and submitted information in relation to income and expenses, analysis of which revealed as under:

- Local employees are hired by CNFA, USA, a US based company, for providing technical assistance under the agreements. The Company merely receives and reimburses the salaries of the employees of CNFA, USA and is not itself executing any part of the contract.
- Accordingly, during the year under review, salaries of local employees of CNFA, USA were received from it and were reimbursed by the Company to the bank accounts of such employees.

3. The Company in the Accounts recognized and recorded salary receipts and payments of employees of CNFA, USA, as its own income and expenses respectively. This is, prima facie, against the criteria for recognition of revenue and expenses set forth by the International Financial Reporting Standards ("IFRS") including International Accounting Standards ("IAS"), which were applicable to the Company, as well as the Accounting and Financial Reporting Standards (the "AFRS"), which the Company followed in preparation of Accounts. The aforesaid receipts and payment are cash receipts and payments rather than income and expenses of the Company, as it merely receives and reimburses the salaries of the employees of CNFA, USA. It appeared that a result of the aforesaid incorrect accounting treatment by the Company, the Balance Sheet and Income and Expenditure Account of the Company were, prima facie, misstated by the amounts wrongly recognized as 'Income-salary receipts', 'Expenditure-salary payments' and 'Accrued Expenses-salaries payable'. Hence, the SCN under section 492 of the Ordinance was issued to the directors, requiring them to explain as to why penal action may not be taken against them for the aforesaid alleged misstatements in the Accounts.

4. In response to the SCN, Syed Murtaza Ali Pirzada, through letter dated July 3, 2015 requested for further time for submission of reply on behalf of the respondents and also requested to provide an opportunity of hearing to explain the case in person. Subsequently, a hearing in the matter was fixed before the Commissioner (Company Law Division), who was the authorized officer as per delegation of powers at that time. The Commissioner, however, directed the



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department to carry out an inspection of the books and papers and record of the Company for further probe and to, inter alia, verify the authenticity and veracity of the amounts received from the CNFA, USA and payments made to the employees. Having carried out an inspection under section 231 of the Ordinance, the relevant wing of the department forwarded the findings and outcome of the inspection along with a copy of inspection report on March 31, 2016. A brief of findings and outcome of the inspection with reference to the contents of the SCN, is given below:

- Inspection was carried out for the record covering the period from June 2012 to October 15, 2015 comprising list of employees and their profiles, payroll ledger, relevant bank statements and detail of salary income and expenditure of the Company.
- It revealed that all the employees including CEO to whom salaries have been paid by the Company are the employees of CNFA-USA.
- The payroll ledgers and relevant bank statements reflect that the salaries have been paid to employees and the tax deducted from their salary income has been duly deposited with the Federal Board of Revenue ("FBR"). However, the Company in the accounts has recognized and recorded salary receipts and payments of employees of CNFA-USA, as its own income and expense respectively against the criteria set forth by the IFRS (*as well as AFRS*) for recognition of revenue and expense.
- The aforesaid receipts and payments are cash receipts and payments rather than income and expenses of the Company, as the Company merely receives and reimburses the salaries of the employees of CNFA-USA.
- It is evident that the balance sheet and income and expenditure account of the Company have been, prima facie, misstated by the amounts wrongly recognized as 'Income –salary receipts', 'Expenditure-salary payments', Accrued Expenses-salaries payable'.

5. Subsequently, the case was fixed for hearing on April 27, 2016. On due date, M. Faheem Akhter, CFO and Syed Murtaza Ali Pirzada, appeared before the undersigned. With reference to the contents of the SCN, they stated that the accounting treatment adopted by the Company was based on their understanding and if the Company could not recognize the receipt from CNFA, USA and payments to employees, then what would be the accounting treatment. They were apprised of the fact that for recognition of revenues and expenses, the criteria set forth by the IFRS, which are applicable to the Company, has to be followed and in case the criteria is not met, these



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receipts and payments are to be recorded only as receipts and payments instead of income and expense. They gave assurance that the Company shall follow the criteria for recognition of revenue and expense in terms of the applicable financial reporting framework in respect of the upcoming accounts of the Company for the year ended June 30, 2016 and requested for a lenient view in the matter.

6. Before proceeding further, it is necessary to advert to the following relevant provisions of Ordinance, IASs:

Section 492 of the Ordinance, states as under:

*"Whoever in any return, report, certificate, balance sheet, profit and loss account, income and expenditure account, prospectus, offer of shares, books of accounts, application, information or explanation required by or for the purposes of any of the provisions of this Ordinance or pursuant to an order or direction given under this Ordinance makes a statement which is false or incorrect in any material particular, or omits any material fact knowing it to be material, shall be punishable with fine not exceeding five hundred thousand rupees."*

## **IAS 18 - Revenue**

8. Revenue includes only the gross inflows of economic benefits received and receivable by the entity on its own account. Amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes are not economic benefits which flow to the entity and do not result in increases in equity. Therefore, they are excluded from revenue. Similarly, in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission. (Emphasis added)

## **The Conceptual Framework for Financial Reporting (the "Framework")**

4.25. The elements of income and expenses are defined as follows:

(a) **Income** is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.



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(b) **Expenses** are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

## Recognition of income

4.47. Income is recognized in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. This means, in effect, that recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities (for example, the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable).

## Recognition of expenses

4.49. Expenses are recognized in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase in liabilities or a decrease in assets (for example, the accrual of employee entitlements or the depreciation of equipment).

In terms of the Commission's notification SRO 1003 (I)/2015 dated October 15, 2015, the powers to adjudicate cases under section 492 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 respondents and my observations are as under:

- a) The Commission through notification SRO 23(I)/2012 dated January 16, 2012 has notified the AFRS for Medium Sized Entities ("MSEs") and Small Size Entities ("SSEs"). Since the Company being a unlisted company does not fall in the definition of MSE or SSE, therefore, in terms of para 3 of the aforesaid notification, it was required to follow the IFRS including the IASs in preparation of Accounts for the year ended June 30, 2014.



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- b) In terms of IAS 8 and para 4.29 and 4.30 of the Framework, the income encompasses both revenue and gains. Revenue is income that arises in the course of ordinary activities of an entity and is referred to by a variety of different names including sales, fees, interest, dividends and royalties. Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an entity. Gains represent increases in economic benefits and as such are no different in nature from revenue. Hence, they are not regarded as constituting a separate element in this Framework. As clearly defined in the IAS 18, revenue includes only the gross inflows of economic benefits received and receivable by the entity on its own account. It is explicitly stated that amounts collected on behalf of third parties are not economic benefits which flow to the entity and do not result in increases in equity and, therefore, are excluded from revenue. Likewise, in an agency relationship, the amounts collected on behalf of the principal are excluded from definition of revenue. However, only the commission, if any, received from the principal, would be the revenue. Since the receipt from CNFA, USA by the Company does not meet the definition of revenue or a gain, it cannot be treated as income or revenue of the Company.
- c) In terms of the para 4.33 and 4.34 of the Framework, the definition of **expenses** encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity. Expenses that arise in the course of the ordinary activities of the entity include, for example, cost of sales, wages and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory, property, plant and equipment. Losses represent other items that meet the definition of expenses and may, or may not, arise in the course of the ordinary activities of the entity. Losses represent decreases in economic benefits and as such they are no different in nature from other expenses. Hence, they are not regarded as a separate element in the Framework. The payments made by the Company on behalf of CNFA, USA to its employees do not meet the definition of 'expense' and, hence, could not be charged to the Income and Expenditure Account.
- d) In terms of paras 4.48 and 4.49 of the Framework, the criteria for recognition of income and expense has been clearly established. Meeting the definition of 'income' and 'expense'



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is the first prerequisite for recognition in the 'income statement' or 'income and expenditure account'. Income is recognized in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. Likewise, expenses are recognized in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. In the instant case, the Company has acted as an agent on behalf of the CNFA, USA to receive cash from it and make payments of salaries to the employees of CNFA, USA. The amounts received from and paid on behalf of CNFA, USA do not meet the definition of income or expense and, therefore, cannot be recognized in the 'Income and Expenditure Account' of the Company. The Company incorrectly charged the receipts and payments from CNFA, USA, as its own income and expenses in contravention with the criteria set forth by the IFRS and the Framework. Consequently, the Accounts of the Company were misstated.

8. I deem it necessary to make some observations on the importance of compliance with requirements of the IFRS and the Ordinance in preparation of financial statements, adequacy and accuracy of disclosures made therein and directors' duties and responsibilities in this regard. 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, adequate and correct disclosures in the financial statements in line with applicable financial reporting framework are of utmost importance. The IFRS provide basis for preparation and presentation of financial statements to ensure understandability, reliability, relevance and comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. The IFRS also set out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. Therefore, it is of utmost importance that all the applicable requirements of IFRS are complied with in letter and spirit. It is the duty of the company and its directors to see that the disclosures made in the financial statements are adequate and correct and there is no misstatement or omission of material facts. In addition to their responsibilities of overseeing and managing affairs of the Company, directors



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also have fiduciary duties towards the Company. They are, therefore, liable to a higher level of accountability which requires them to be vigilant and perform their duties with care and prudence. It is directors' responsibility to oversee the functioning of the company, to keep it appropriately staffed and organized to ensure due compliance of law. In this context the respondents cannot absolve themselves of their statutory duties regarding misstatements in the financial statements.

9. For the foregoing reasons, I am of the view that the respondents have made themselves liable for action under the provisions of section 492 of the Ordinance. However, I take cognizance of the fact that the Company is a not for profit organization registered under section 42 of the Ordinance. Moreover, the respondents have shown their willingness and have given assurance to ensure preparation of the upcoming Accounts for the year ended June 30, 2016 in line with the requirements of applicable financial reporting framework. Therefore, in exercise of the powers conferred by section 492 of the Ordinance, instead of imposing fines, I hereby conclude the proceedings with a stern warning to the respondents to be careful in future and ensure meticulous compliance with applicable provisions of the Ordinance and IFRS.

Before parting with the Order, I hereby direct the chief executive and directors of the Company to ensure preparation of Accounts of the Company for the year ended June 30, 2016 strictly in accordance with the applicable financial reporting framework and the provisions of the Ordinance. It may be noted that non-compliance with the direction will hold them liable for action under section 495 of the Ordinance.

**Abid Hussain**  
Executive Director (CSD)

**Announced:**  
June 13, 2016  
Islamabad