



Before Mr. Abid Hussain, Executive Director

In the matter of

Mahboob Sheikh & Co., Chartered Accountants - Auditors of Iris Pharmaceuticals (Private) Limited

Number and date of show cause notice	CSD/ARN/333/2016 dated July 27, 2016
Date of Hearing	November 14, December 19 and January 16, 2016
Present	None

ORDER

Under Section 260 read with Section 476 of the Companies Ordinance, 1984

This order will dispose of the proceedings initiated against Mr. Mahboob Ahmad Sheikh, audit engagement partner of Mahboob Sheikh and Company, Chartered Accountants (the respondent), in respect of the audit of annual financial statements (the "accounts") of Iris Pharmaceuticals (Private) Limited ("the Company") for years ended June 30, 2010 through to June 30, 2015 ("subject years"). The proceedings were initiated through show cause notice dated July 27, 2016 under provisions of Section 260 read with Section 255 and 476 of the Companies Ordinance, 1984 ("the Ordinance").

2. The brief facts of the case enumerate from examination of accounts of the Company for subject years transpired that the Company had not been engaged in any kind of production or trading activities, the operations have not commenced since incorporation in the year 2005 and thereby the Company has been reporting nil sales. Further, it was noted that the Company has been incurring operating losses and its operating cash flows have been negative during all the aforementioned years. The directors in their report to shareholders in the aforesaid years have consistently stated that owing to un conducive economic conditions for investment, the implementation of the project may delay.

3. It was also noted that the Company, despite facing persuasive going concern issue, continued to prepare (note 2.2. of the aforesaid years) underlying accounts under historical cost convention and omitted



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disclosure of going concern issue and related uncertainties in its notes to the accounts in contravention to International Accounting standards (IAS). Inappropriate use of basis of preparation of accounts and omission of material facts regarding Company's ability to continue as going concern renders the underlying accounts as misleading and misstated.

4. The respondents, being statutory auditor of the Company for years 2010 to 2015, were required to either express adverse or qualified opinion in accordance with the International Standards on Auditing ("ISA") i.e. ISA 705 and 570 ISA 705 and 570 owing to aforementioned misstated and misleading financial statements. However, the respondents issued the following audit report for the aforementioned years:

- a) 2010: unqualified opinion on the financial statements for year ending June 30, 2010
- b) 2011, 2012, 2013 & 2014: auditor added emphasis of matter that too regarding going concern uncertainty rather than inappropriate use of going concern
- c) 2015: unqualified opinion on the financial statements for year ending June 30, 2015.

In view of the above, the auditor failed to bring out material facts about the affairs of the company, inadequate disclosures by the management given in the accounts 2010 through to 2015 regarding material uncertainty and inappropriate use of going concern assumption.

5. Keeping in view the facts enumerated above, a show cause notice under Section 260 read with Section 255 and 476 of the Ordinance dated July 27, 2016 was issued to the respondents, advising them to show cause within 14 days of the date of the notice as why penal action may not be taken against them for failing to perform the audit of financial statements as per requirement of the Ordinance and relevant ISAs and make a report to the shareholders in accordance thereof.

6. The respondent in its reply to said show cause vide letter dated August 30, 2016, stated that:

- For purpose of going concern assumption ISA 570 states, '*an entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease operation or has no realistic alternative but to do so*'.



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For non-going concern either of the condition i.e. liquidation or ceasing of business is necessary. The word cease operation is clear indication that company was in operation and now is forced to cease operations. A Company will liquidate when it becomes bankrupt which is possible only if it starts business.

- In case of the company both the conditions i.e. liquidation or to cease operations do not exist.
- Directors have expressed their intention to setup and run pharmaceutical industry however it may delay.
- Director have evaluated that there is no need of liquidation. The director has visited Singapore, Korea, Hong Kong and China etc. and has negotiated with some international pharmaceutical companies for collaborations. The hindrance is non-availability of regular supply of electricity and foreign collaboration for commercial production.
- There is no condition that there are no conditions which make the company non-going concern.
- In our judgement, as, auditor, the company is a going concern and it is prerogative of auditor to judge.

7. An opportunity of hearing in the matter was provided to the respondents of the said show cause notice on October 20, 2016 adjourned to October 21, 2016, owing to technical anomalies the said hearing was again rescheduled to November 14, 2016. The respondent through letter dated November 04, 2016 communicated inability to attend the hearing at Company Registration Officer ("CRO") Lahore and requested the same to be held via videoconference in CRO, Multan. The hearing was again held at Multan however owing to technical anomalies it was re-fixed on December 19, 2016. No one appeared on behalf of respondents. A final opportunity of hearing was given on January 16, 2017. The respondents did not appear on the date of hearing.

8. In terms of notification S.R.O 1003(I)/2015 dated October 15, 2015 the power to adjudicated cases under Section 260 of the Ordinance has been delegated to Executive Director (Corporate Supervision Department).



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9. Before elaborating facts of the subject case, I would quote relevant paras of ISAs and Ordinance is given below:

ISA 570- Going concern

Para 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.

Para 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)

Para 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.

Para 17:

Based on the audit evidence obtained, 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. A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary for: (Ref: Para. A19)

- (a) In the case of a fair presentation financial reporting framework, the fair presentation of the financial statements, or*
- (b) In the case of a compliance framework, the financial statements not to be misleading.*

Para 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)*



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Para 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 18.5 (Ref: Para. A21–A22)*

Para 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)

Para 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)

ISA 705- Modification to the opinion in the Independent Auditor's report

Para 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)*

Section 255 of the Ordinance prescribes powers and duties of the auditors, the manner, requirements and contents of auditors' report on the accounts. Rule 17 (A) of the Companies (General Provisions and Forms) Rules, 1985 requires that auditor's report shall be on prescribed format contained in Form 35-A.

Section 260 of the Ordinance states that,

"(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



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auditor shall, in addition to the penalty provided by that sub-section, be punishable with imprisonment for a term which may extend to 1[one year] and with fine which may extend to 2[one hundred] thousand rupees.”

10. I have gone through the requirements of law, explanation provided by the Company and facts placed before me by the Department. In the order of incidence of events, I have observed the following:

- a) The Company failed to start its operations and reported nil sales since its incorporation in 2005.
- b) Despite persuasive conditions of material uncertainty that continued to exist since its incorporation in 2005 till year 2015, the Company continued to prepare its financial statements on going concern assumption and omitted disclosure of going concern uncertainties in its notes to the accounts.
- c) In view of inadequate disclosure regarding material uncertainty and inappropriate use of going concern assumption, the respondent being statutory auditor of the Company was required to either express adverse or qualified opinion in accordance with the ISA 705 and 570.
- d) Instead, respondent in his report for year 2010 issued clean report, for years 2011-2014 merely added an emphasis of matter paragraph that too regarding going concern uncertainty rather than inappropriate use of going concern. Moreover, despite persistence of aforesaid uncertain conditions, audit report for year 2015, failed to express qualified or adverse opinion in contravention of ISA 705 and 570.
- e) ISA 570 has been referred by respondents stating that it pertains to a company that has commenced operations and then intends to liquidate or cease such operation. The respondent has conveniently omitted to recognize that the said ISA states that under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. Moreover, ISA states that general purpose financial statements are prepared on a going concern basis unless a company intends to liquidate, cease operations or has no realistic alternative but to do so.
- f) The respondents have mentioned that directors in their report had expressed intention to start operations however was facing delay. However, no such disclosure was found in directors' report. Rather the directors' report concluded that the economic conditions are not conducive for investment and owing to liquidity crunch the project may delay. This disclosure persisted throughout the years 2010-2015.



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- g) Similarly, there was no disclosure in directors' report regarding non-availability of power and foreign collaboration being hindrance in restarting operations. The only hindrance in starting operations is procuring financing from banks.
- h) It is pertinent to note that the respondent failed to demonstrate in its submission, evidence of adopting appropriate audit procedures (in absence of operational activity) or additional audit procedures (persistent conditions in year 2010-2015) for conducting audit, failed to determine viability of management plans/ negotiations stated to be undertaken by Company and thereby failed to make appropriate opinion in audit report.
- i) For sake of argument and without prejudice to the above, complete reliance of respondents on director's judgement, keeping all other factors aside, is against the spirit and purpose of independent audit of financial statements.
- j) As for prerogative of auditor to judge going concern assumption, the aforementioned ISAs are clear and thereby responsibility of auditor to perform audit and make a report to shareholders is explicitly stated in the Ordinance.
- k) The respondents failed to perform the audit of the financial statements of the Company as per the requirements of Section 255 of the Companies Ordinance, 1984 and relevant ISAs and make a report to the shareholders in accordance thereof.

11. The Company has not been operational since its inception in 2005 and Directors have consistently stated that economic conditions are not conducive to start operations. This in itself is enough to establish conditions of uncertainty faced by the Company to continue as going concern. Also persistent presence of the same uncertain conditions i.e. from 2010 to 2015, is a fitting alert for an auditor to raise red flag about the decision of the Company to prepare its accounts on going concern assumption. The respondent however failed at detecting, verifying and concluding appropriately the basis of preparation of underlying accounts and omission of material disclosure by Company. This tantamount to respondent not performing audit as per the legal requirements and relevant ISAs, not modifying opinion appropriately and thereby failing to bring out material facts of the affairs of the Company in his report to shareholders. The debate on audit procedures adopted by respondent is futile as the respondent have failed to present or contend that management's future plan, if any, were carefully analyzed and admitted that its appropriateness was not judged by the respondent and that too for several consecutive years. This is itself enough to establish negligence of the respondents in performing duties as auditor of the Company.



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12. A statutory auditor is bound to follow the requirements of the Ordinance, relevant Rules, ISAs and express an opinion using professional judgement and maintaining professional skepticism. Also, in specific context of auditor's responsibilities in the audit of financial statements relating to management's use of the going concern assumption in the preparation of the financial statements, ISA 570 is very vocal and clear. This includes obtaining sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern assumption in the preparation of the financial statements, to conclude whether a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and to determine the implications for the auditor's report. The Indicative conditions are also given that impact the ability of a company to continue as going concern. The duties and responsibilities of an auditor appointed by the shareholders under the law speaks of a watchman through which the shareholders seek an independent view as to how the directors have managed the affairs of the company. Therein the auditor is required to exercise due care and diligence in performing their duties and discharging their responsibility and maintain the trust and integrity.

13. For the foregoing reasons, I am of the view that the respondents in their audit reports for years 2010 to 2015 failed to appropriately modify his opinion and hence has not discharged his duties under the law. However, keeping in view of the fact that the Company, being audited, is a private company, I hereby conclude the proceedings with a stern warning to the respondents to be careful in future and ensure compliance of law in its true letter and spirit.

Abid Hussain
Executive Director
Corporate Supervision Department

Announced:

March 20, 2017