Corporate Supervision Department
Company Law Division

SECP

Before Ali Azeem Ikram – Executive Director (Corporate Supervision)

In the matter of

Mr. Mushtaq Ali Hirani Partner Deloitte Yousuf Adil Chartered Accountants
Auditor of Arif Habib Foundation

Number and date of notice:	CSD/ARN/168/2015-1048 dated October 15, 2015
Date of hearings:	November 12, 2015
Present:	Ms. Hena Sadiq – Director, Deloitte Yousuf Adil Chartered Accountants

ORDER

UNDER SECTION 260 READ WITH SECTION 255 & 476 OF THE COMPANIES ORDINANCE, 1984

This order shall dispose of the proceeding initiated against Mr. Mushtaq Ali Hirani Partner Deloitte Yousuf Adil Chartered Accountants ("respondent") through show cause notice (the "SCN") dated October 15, 2015 under the provisions of Section 260 read with Section 255 and 476 of the Companies Ordinance 1984 (the "Ordinance").

2. The facts leading to this case, briefly stated, are that, the examination of the annual audited accounts for the year ended June 30, 2014 (the "Accounts") of Arif Habib Foundation (the "Company") revealed that, respondent being the auditor of the Company prima facie, failed to make their audit report (the "Report") to the members of the Company in conformity with the Form 35 A as prescribed under Rule 17A of the Companies (General Provisions & Forms) Rules, 1985 ("Rules").

3. Furthermore, Accounts of the Company revealed the following discrepancies:

i. The breakup and details of the "Donation Received" and "Grants Paid" have been given in the Accounts in contravention to para 2(A) of Part III of the Fifth Schedule to the Ordinance which states that the Income & Expenditure Account shall disclose all material items of income and expenses.

ii. As per note 2 to the Accounts these financial statements have been prepared in accordance with the guidelines for accounting and financial reporting by non-government/non-profit organizations as issued by the Institute of Chartered Accountants of Pakistan. In terms of para 3 of the Commission's notification number 23(I)/2012 dated January 16, 2012 , as applicable at the relevant time, the company neither being a small company nor being a medium sized company, was required to follow International Financial Reporting Standards ("IFRS") in preparation of its Accounts.

4. The respondent while making out their report to the members neither stated the aforementioned omission nor did he express an appropriate opinion on them. The audit report on the aforesaid accounts was prima facie, not in accordance with the requirements of Section 255 of the Ordinance and International Standard on Auditing ("ISA") and failed to bring out material facts about the affairs of the Company. Therefore, SCN was issued to the respondent for *prima facie*, contravention of Section 255&260 of the Ordinance.

5. The reply to SCN was submitted by the respondent vide letter dated October 29, 2015. The seriatim reply is summarized below.

- The Auditors report as per Form 35A as prescribed under Rule 17A of the Rules would not be appropriate in the light of the Company's limited operations and use of Form 35-A could cause to include exceptions/qualifications that would mislead the users of financial statements. On the other hand, the audit report as prescribed by the Institute of Chartered Accountants of Pakistan ("ICAP") Technical Release ATR-17 appear to be more appropriate. Auditor opted to use the report prescribed under the ATR.

- This Company is limited by guarantee and has 4 directors on its Board. The financial statements are prepared primarily for submission to the Commission and the taxation authorities. The donation received by the Company is funded only by one of its director while the grants paid relates to identified individuals and welfare organizations. Management is of the view that the guideline does not prescribe any such disclosures and this disclosure would not serve any purpose as the board is already aware of relevant details of donor and prescribed donees.

- The Company is neither a listed company nor a subsidiary of listed company, its financial statements are to be prepared in accordance with the requirements of the Fifth Schedule to the Ordinance. Clause 1(A) of the Fifth Schedule states that all Medium-Sized and Small-Sized companies as defined in this Schedule shall follow the Accounting and Financial Reporting Standards for Medium-Sized Companies and Small-Sized Companies, whichever is applicable, in regard to accounts and preparation of balance sheet and profit and loss account as are specified for the purpose by the Commission under sub-section (3) of section 234 of the Ordinance. You would note from the perusal of the financial statements of the Company that its accumulated fund amounted to Rs. 324,602, and had annual turnover less than Rs. 250 million, as at and for the year ended June 30, 2014. It had employees less than 250 during the year ended June 30, 2014. It is our considered view Section 234 (2) of the Ordinance is the governing provision defining the accounting framework that has to be followed by an entity according to its status. Therefore, we are of the view that IFRS were not required to be followed by the Company. The Company has adopted the 'Guideline For Accounting and Financial Reporting by Non-Government Organizations (NG0s)/Non-Profit Organizations (NP0s)' (the guidelines) approved and issued by the Institute of Chartered Accountants of Pakistan. It is mentioned in para 2.1 therein that these guidelines are also applicable on companies registered under section 42 of the Ordinance. The said guidelines were issued by ICAP in 2009 owing to the fact that none of the prevailing standards fulfilled the accounting requirements of the not-for-profit organizations.

6. In order to provide opportunity of personal hearing; the case was fixed before the undersigned on November 12, 2015. Ms. Hena Sadiq appeared on behalf of respondent before the undersigned and reiterated the earlier stance taken by the respondent in the written reply. Based on the submission she requested a lenient view in the matter.

7. Before proceeding with the order, it is appropriate to quote the provisions of Section 255(3) of the Ordinance stipulating duties of auditors. It requires that the auditor shall make a report to the members of the company on the accounts and books of account of the company and on every balance sheet and profit and loss account and on every other document forming part of the balance sheet and profit and loss account, including notes, statements or schedules appended thereto, which are laid before the Company in general meeting during their tenure of office, and the report shall state:

(d) *whether or not in their opinion and to the best of their information and according to the explanations given to them, the said accounts give the information required by this Ordinance in the manner so required and give a true and fair view in the case of the balance-sheet, of the state of the company's affairs as at the end of its financial year; in the case of the profit and loss account or the income and expenditure account, of the profit or loss or surplus or deficit, as the case may be, for its financial year; and in the case of the statement of changes in financial* *position or sources and application of funds of a listed company, of the changes in the financial position or the sources and application of funds for its financial year;*

8. Furthermore, the provisions of Section 255(4) of the Ordinance requires that where any of the aforesaid matters is answered in the negative or with a qualification, the report shall state the reason for such answer along with the factual position to the best of the auditors' information.

9. Para A 1 and A 12 of the ISA 200 *"Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with ("ISA 200"*) state as under:

> ***A1.*** *The auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. The auditor's opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. In some jurisdictions, however, applicable law or regulation may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. While the ISAs include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions.*
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> ***A12.*** *The opinion expressed by the auditor is on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. The form of the auditor's opinion, however, will depend upon the applicable financial reporting framework and any applicable law or regulation. Most financial reporting frameworks include requirements relating to the presentation of the financial statements; for such frameworks, preparation of the financial statements in accordance with the applicable financial reporting framework includes presentation.*

10. *ISA 705* states as under:

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

(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

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)

11. In terms of the Commission's notification SRO 1003 (I)/2015 dated October 15, 2015, the powers to adjudicate cases under section 255 & 260 have been delegated to Executive Director (Corporate Supervision).

12. I have analyzed the facts of the case, relevant provisions of the Ordinance and ISA, arguments put forth by the respondent and representative and observed the following;

- The Auditor's Report does not conform to Form 35 A as prescribed under Rule 17 A of the Rules. The aforesaid provision of the law shall prevail in the matter and override the requirements of ATR 17 issued by ICAP. The statutory auditor of a company is not empowered to decide whether the prescribed format is appropriate in case of a particular company. The power to allow any deviation/exemption from prescribed format rest with the Commission.

- As per para 2A of part III of the Fifth Schedule to the Ordinance, the income and expenditure account shall disclose all material items of income and expenses. However, no breakup and details of the "Donation Received" and "Grants Paid" have been given in the Accounts. The fact that all donations were received from single donor who is also a director of the Company should have been disclosed. However this fact does mitigate the non-disclosure to a large extent.

- As per para 1A of part I of the Fifth Schedule, non-listed companies that are not medium sized companies or small sized companies shall follow the IFRS notified by the Commission for the listed companies under subsection 3 of section 234 of the Ordinance.

Section 42 companies, virtue of their structure and objectives, usually do not have share capital and as such cannot meet the qualifying criteria laid down for medium sized companies or small sized companies. Addressing this difficulty, the Commission vide SRO 23(I)/2002 dated January 16, 2012 stipulated that non listed companies which are neither medium sized companies or small sized companies shall follow the IFRS. However the financial statements of the Company have not been prepared in compliance with IFRS and respondent did not identify this noncompliance in its report. It is however acknowledged that keeping in view the size of the Company and limited number of transactions disclosure in accordance with IFRS would not have materially added/changed the information already disclosed in the accounts. Furthermore, subsequent to the signing of the audit report Commission vide S.R.O. 929(I)/2015 dated September 10, 2015 now requires from small and medium sized companies licensed/formed under Section 42 and 43 of the Ordinance which has annual gross revenue including other income less than Rs. 200 million to follow IFRS for SMEs issued by International Accounting Standards Board as adopted in Pakistan by council of ICAP.

13. For the foregoing reasons, I am of the firm opinion that the respondent failed to bring about material facts about the affairs of the Company and accordingly auditor's report has not been made in conformity with Section 255 & 260 of the Ordinance. However, keeping in view submissions made by the respondent and other mitigating circumstances as discussed in the preceding paragraph; instead of imposing fine, I hereby, conclude the proceedings with a warning to the respondent to be careful and ensure compliance with mandatory provisions of the Ordinance and ISA, in true letter and spirit; in future.

Ali Azeem Ikram
Executive Director (Corporate Supervision)

Announced:
December 1, 2015
Islamabad