SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
SPECIALISED COMPANIES DIVISION

Before Sadia Khan, Executive Director

IN THE MATTER OF

M/S. TASEER HADI KHALID & CO., CHARTERED ACCOUNTANTS

STATUTORY AUDITORS OF

PARAMOUNT LEASING LIMITED

Date of Hearing:	April 22, 2002
Present:	Masood Naqvi for and on behalf of Taseer Hadi Khalid & Co. Chartered Accountants. Mr. Asif Jalal Bhatti, Deputy Director

ORDER UNDER SECTION 254 READ WITH 476 OF THE COMPANIES ORDINANCE, 1984

1. M/s. Taseer Hadi Khalid & Co. (THK), Chartered Accountants have been acting as statutory auditors of M/s. Paramount Leasing Limited (PLL) since its inception in 1992. They were re-appointed for the financial year 1999-2000 in the Annual General Meeting of PLL held on November 1, 1999. In terms of Rule 19 of the Leasing Companies (Establishment and Regulation) Rules, 2000, M/s. Muniff Ziauddin & Co., Chartered Accountants were appointed by this office to conduct the special audit of PLL for the year ended June30, 2000. The special auditors observed that THK had availed a lease facility during the period of their audit assignment with PLL in respect of a motor vehicle, amounting to Rs. 375,000/- from PLL on October 15, 1998 for a period of four years.

2. In terms of clause (d) to sub-section (3) of section 254 of the Companies Ordinance, 1984 (the "Ordinance"), " a person who is indebted to the company shall not be appointed as auditor of that company". Prima facie, THK were indebted to PLL for an amount of Rs. 375,000/- and were, therefore, not qualified to act as statutory auditors of PLL for the financial year 1998-99 and 1999-2000 in terms of sub-section 3(d) of Section 254 of the Ordinance. Further, Section

254 (6) provides that "a person who, not being qualified to be an auditor of a company, or being or having become subject to any disqualification to act as such, acts as auditor of a company shall be liable to fine which may extend to twenty five thousand rupees".

3. On the basis of the observations made by M/s. Muniff Ziauddin & Co., Chartered Accountants, a notice dated January 7, 2002 was issued to THK to Show Cause in writing within fourteen days of the receipt of the said Notice, as to why a fine may not be imposed on them as provided under sub-section (6) of Section 254 of the Ordinance for the above mentioned violation of the law.

4. In response to the said Show Cause Notice, THK vide letter dated January 21, 2002 emphasized the following issues;

a) that they were not at any time and are not indebted to PLL, an audit client, in terms of provision of Clause (d) of Sub-Section (3) to Section 254 of the Ordinance.

b) that the lease facility to acquire motor vehicle on lease was made under a specific Lease Agreement which clearly stipulated that the ownership of the leased vehicles vests in the Leasing Company and that they were using it under the Lease Agreement for consideration of the lease rentals paid by them.

c) that the said lease facility is not a financing collateralized against the motor vehicle as the agreement is that of lease rental. Since the motor vehicle is in ownership of PLL, it is not a security or collateral for a loan.

d) that the motor vehicle is a moveable property and is registered in the name of PLL and is insured in its name. Further, THK is only the user of the vehicle against payment of lease rentals and is bound to return it to PLL as and when demanded.

e) that the lease agreement does provide for option of entering into a further lease term if agreed by Lessor, otherwise the vehicle is to be returned to PLL.

f) that the agreement does not contain any option to buy the vehicle on expiry of the term.

g) that the Agreement clearly demonstrates that they have not taken any loan and are not indebted to PLL in any form other than for lease rentals which are paid on due dates and that no defaults have ever occurred to constitute a liability on account of THK.

5. In light of the above arguments, THK pleaded that the leasing arrangement is fully consistent with the International Federation of Accountants (IFAC) Code of Ethics adopted by Institute of Chartered Accountants of Pakistan and that the Show Cause Notice was premised on a mistaken assumption that leasing arrangement constitutes any form of indebtedness.

6. The above-mentioned arguments put forward by THK were duly considered by this office and following observations were made: -

i) The arguments mentioned by THK at point (a), could not be accepted, as lease rental is an obligation that has to be paid by the lessee and therefore, a debt in the ordinary meaning of the term "indebtedness".

ii) The arguments stated at point (b) were not acceptable as every form of indebtedness whether loan, advance or any other form of finance facility is always under a specific agreement / terms and conditions. Further, the payments made by THK were in respect of an outstanding liability that was created as a result of that lease transaction.

iii) The reasons stated by THK at point (c)& (d) were not tenable as the provisions of Lease Agreement in respect of the ownership of the leased vehicle, are nothing more than the contractual remedies available to the lessor to repossess the asset under the lease contracts. Repossession by the lessor does not absolve the lessee from his obligation to pay the outstanding lease rentals.

The other arguments pertain to the terms and conditions of the lease agreement, therefore, do not require any clarification/comments.

7. The term "indebtedness" has not been expressly defined in the Ordinance and the law is silent on whether lease facilities can be treated as indebtedness or not. Therefore, to clarify the issue, this office invited the attention of THK to other existing laws/statutes in Pakistan and made a reference to Section 2(ii) of State Bank of Pakistan Act (XXXII of 1956) in which leasing is included in the definition of "Loans and Advances" vide its letter dated February 21, 2002.

8. In response, THK argued that it is an established principle of law that the definition given in a statute is for effectuating the provisions of that statute and not for effectuating the provisions of another statute. They also referred to the judgement of Supreme Court of Pakistan which read thus:-

> "*It is next urged on behalf of the appellants that, since on his own showing the said respondent was acting as a commission agent of the bank, he fell within the category of the "agent" mentioned in clauses (b) and (d) of the said section. Here again, we are asked to come to this conclusion by giving to the word "agent" the meaning given to it in the Contract Act and to hold that any person employed to do any act for another comes within this category. We are again unable to accede to this request, for, it is always unsafe to interpret words in one statute with reference to the sense in which the same words may have been used in other statutes, unless they be in pari materia.*"

9. This office has reviewed the above-referred judgement and it has been observed that the definition of "Loans and Advances" – which are known forms of indebtedness - as given in Section 2(ii) of State Bank of Pakistan Act (XXXII of 1956) delineates all such financing arrangements which may be considered a form of loan or advance, hence indebtedness.

Therefore, the said Act may be construed as *in pari materia* for the purposes of assigning the meaning to the term indebtedness in order to remove inconsistency in the Ordinance. As per Black's Law Dictionary, "*it is a canon of construction that statutes that are in pari materia may be construed together, so that inconsistencies in one statute may be resolved by looking at another statute on the same subject*".

10. Moreover, I would like to make a reference to the practice prevailing in India in respect of disqualification of statutory auditors on account of indebtedness. The guidance given by the Institute of Chartered Accountants of India in this regard states "if the amount outstanding from an auditor of the company regarding goods and services purchased from the company, audited by him, exceeds Rs. 1,000/-, irrespective of the nature of purchase or period of credit allowed to other customers, the provisions regarding disqualification of auditor will be attracted" *[Guidance Note on Independence of Auditors]*. This disqualification is attracted when the auditor is indebted to the company for an amount exceeding one thousand rupees or if he has given a guarantee or provided any security in connection with indebtedness of any third person to the company for an amount exceeding one thousand rupees. This disqualification seeks to ensure independence of auditors by his not being under such obligation.

11. The Institute of Chartered Accountants of India has opined (*Compendium of Guidance Notes, September 1985,p.121)* that when the firm is indebted to the company, each and every partner of the firm is also deemed to have been indebted, and the vice versa is also true. Where, for example, the auditor has purchased goods from the auditee company and yet not paid for them, he is said to be indebted.

12. Considering the above-mentioned facts and in order to provide an opportunity of being heard to THK, a hearing was fixed on 22nd April 2002. On behalf of THK, Mr. Masood Naqvi appeared before me on the said date and expressed his viewpoint. He submitted that the lease facility availed by THK falls outside the ambit of section 254 of the Ordinance and cannot be construed as indebtedness in accordance with the standards of independence under IFAC and ICAP Code of Ethics.

13. In response, the following in-house legal position was brought to the notice of Mr. Masood Naqvi:-

> "The word indebtedness is not defined in the Ordinance. Therefore, under the principle of statutory construction applied in Pakistan the word indebtedness is to be given its natural dictionary meaning. A lease transaction creates an obligation on the lessee to remain current on his lease rental payment obligations. This is a quantified obligation and therefore, a debt in the ordinary meaning of that word, the agreement advanced by M/s. Taseer Hadi Khalid & Co., (THK) that the lessor may repossess the vehicle is nothing more than the contractual remedy available to the lessor under the lease contracts. Repossession by the lessor does not absolve the lessee from his obligation to pay the outstanding lease rentals".

14. In response to the query raised by this office regarding terms and conditions of Lease Agreement, Mr. Masood Naqvi claimed that the lease transaction entered by THK with PLL in

1998 was in the normal course of business of PLL and was executed on the terms and conditions generally applicable to all the customers of PLL. Further, he was advised to furnish the details of the terms and conditions regarding car leases entered by THK with other leasing companies during 1998 and 1999, which were furnished by THK vide letter dated 23rd April, 2002. It was observed that the terms and conditions were almost the same in all the leases availed from other leasing companies.

15. I find it expedient to mention here the spirit of law in respect of section 254 of the Ordinance. The said section was included in the Ordinance in order to prevent any favour to be extended to a company by its auditors under obligation of loans and advances. Therefore, to determine that whether or not any favour was extended to THK, this office has considered the terms and conditions of the lease agreement in light of the leasing arrangements being carried out by PLL with other lessees. After a detailed scrutiny, this office has found that "terms and conditions" of lease agreement between PLL and THK were at par with the terms and conditions prevailing in the market at that time (1998). The lease agreement between PLL and THK depicts a standard format followed by all leasing companies undertaking vehicle finance business. This office reviewed several lease agreements obtained from various leasing companies that were executed during 1998, in light of which it was established that the provisions of these lease agreements were of a similar nature with respect to title, security, insurance, default etc.

16. In conclusion, the issue of whether THK were indebted to their client during the course of their audit assignment, I tend to believe that the lease arrangement does fall under the definition of the term indebtedness. However, in this particular case, having satisfied myself with the manner in which this particular transaction was executed, i.e. in line with prevailing market terms and without undue consideration shown towards the lessee, I am inclined to take a lenient view since the spirit of section 254 was not violated.

17. No penalty is, therefore, imposed on THK in pursuance of the show cause notice dated January 7, 2002. However, they are hereby warned to be careful in the future and to desist from entering into any commercial transaction with their audit clients, which could impair their impartiality towards the client and be regarded as conduct unbecoming of a professional and independent firm of accountants.

18. Issued under my hand and seal this 30th day of May, 2002.

(Sadia Khan)
Executive Director