Securities and Exchange Commission of Pakistan
Enforcement and Monitoring Division
NIC Building, Jinnah Avenue, Blue Area, Islamabad

Before Rashid Sadiq, Executive Director

In the matter of
MR. PHINEHAS SALAMAT, FCA

Number and date of show cause notice	19 (721) CF / ISS/2001 April 08, 2002
Date of hearing	May 20, 2002
Present	Mr. Arshid Rathor

ORDER UNDER SUB-SECTION (1) OF SECTION 260 OF THE COMPANIES ORDINANCE, 1984

This Order will dispose of the show cause proceedings initiated against Mr. Phinehas Salamat, FCA under Section 260 of the Companies Ordinance, 1984 (the "Ordinance").

2. Mr. Phinehas Salamat is a Fellow Member of the Institute of Chartered Accountants of Pakistan (the "ICAP'). He was registered with ICAP on July 01, 1995 under registration number 2423. He is a practicing Chartered Accountant and is conducting his business under the name and style of '**Phinehas & Co.**' at 105, Nawab Plaza, 48- Main Shadman Market, Lahore.

3. The relevant facts for the disposal of this case are not complex. M/s Phinehas & Co., Chartered Accountant was appointed as Auditor of M/s Muslim Ghee Mills Limited (the "Company") in its Annual General Meeting held on December 21, 2000 to hold office from the conclusion of the said meeting until the conclusion of next Annual General Meeting.

4. The Commission has conducted an examination of the financial statements of the Company for the year ended June 30, 2001 (the "Accounts") to determine, among other things, as to whether the Auditor's Report pertaining to the aforesaid financial year has been made in conformity with the requirements of Section 255, is otherwise true, contained no statement, which is materially false and that there is no omission of material facts about the affairs of the Company.

5. The aforesaid examination of the Company's Accounts revealed that the Company has not observed the following requirements of the International Accounting Standards (IAS) in regard to the accounts and preparation of the Balance Sheet and Profit and Loss Account for the year ended June 30, 2001:

i. Disclosures of financial instruments as per Para 56, 66 and 77 of IAS 32 (Financial Instruments: Disclosure and Presentation).

ii. Disclosure of number of employees as per para 102(d) of IAS 1 (Presentation of Financial Statements).

iii. Disclosure of revaluation of fixed assets as per para 64(e) of International Accounting Standard 16 (Property, Plant and Equipment).

6. Mr. Phinehas Salamat, the Auditor of the Company, however, has not drawn attention of the members towards the aforesaid non-disclosures in his Audit Report signed on December 03, 2001 and instead has given an opinion that the balance sheet, profit and loss account, cash flow statement and statement of changes in equity conform with approved accounting standards as applicable in Pakistan. It was further observed from the perusal of the Accounts that the statement of changes in equity has not been prepared and annexed to the accounts whereas the Auditor has given opinion in his report to the members on the said Accounts that the statement of changes in equity conform with the approved accounting standards as applicable in Pakistan and give the information required by the Ordinance in the manner so required and give true and fair view of the changes in equity for the year. It was also noticed that the Auditor has failed to modify opinion paragraph of his report to the members of the Company to reflect his qualifications on non-provisioning of depreciation, preparation of accounts on going concern basis, scope limitation imposed by the Company to circulate the confirmation letters and non-compliance of International Accounting Standards by the Company.

7. In view of the above, the Commission felt concerned about the quality of audit of the Company conducted by M/s Phinehas Salamat & Co., Chartered Accountant. This appeared to be a case where the Auditor has *prima facie* failed to report in conformity with the requirements of Section 255 and the report is otherwise untrue and contained a statement, which was materially incorrect. A Show Cause Notice dated April 08, 2002, therefore, was issued to Mr. Phinehas Salamat to show cause, in writing, within seven days to explain as to why action under Section 260 of the Ordinance may not be taken against him for the aforesaid contraventions. The reply to the show cause notice was received through letter dated April 15, 2002. In order to provide an

opportunity of personal hearing, the case was fixed on May 20, 2002. Mr. Arshid Rathor represented Mr. Phinehas Salamat at the time of hearing.

8. In the written submissions as well as at the time of hearing, it was contended that there was no material movement in the financial statements of the Company, which required any particular disclosure and presentation as the report clearly stated that the Company had ceased its operations since July 16, 1996. As regards to other issues raised in the show cause notice, it was averred that there was no such material item of financial instruments, which was required to be disclosed. All the components as required by Para 7 of IAS 1 were produced in the financial statements ***except*** statement of changes in equity. As there was no major change in the equity during previous and current years, therefore, a typical statement of changes was not produced. As regard to the truth and fairness of the opinion is concerned, it was stated that this opinion was subject to the matters stated in the first para of the auditors' report.

9. Before proceeding to discuss the contentions of Mr. Phinehas Salamat, I deem it necessary to make some observations on the role of auditors of a company. They being the ultimate watchdog of the shareholders interests, are required to give a report on the accounts and books of accounts after conducting the audit in accordance with the prescribed procedures and requirements of the Ordinance and Standards. If they found any irregularity, they are required to issue a modified report, if the said irregularity is material to the accounts. Otherwise they issue a clean report to the shareholders. The shareholders, therefore, are the ultimate entity to whom the auditors are responsible. They must keep this fact in mind while auditing the books of accounts and reporting thereon. It is the management of companies, which by virtue of their majority power hire and fire the auditors. In these circumstances, the auditors often violate the mandatory

provisions to accommodate their clients with a favourable report to ensure a continuity of their appointment. Realizing this situation, the Commission has recently taken several measures to protect the integrity and performance of the auditors in order to safeguard the interest of investors and general public.

10. Now, I will address the arguments advances on behalf of Mr. Phinehas Salamat. I have given careful consideration to all the submissions made on behalf of Mr. Phinehas Salamat and come to the conclusion that the irregularities and violations pointed out in the show cause notice have not been considered seriously by the auditor. The argument that there was no such material item of financial instruments is not based on facts. There are financial assets and liabilities to the tune to Rs. 5 million and Rs. 32 million respectively at the balance sheet date, which should have been disclosed in accordance with IAS 32. The contention that statement of changes in equity was not included in the accounts as there was no major change in the equity is not a justifiable reason for giving an opinion on the statement, which was not audited. This is another serious violation by the auditor. I would like to refer to para 86 of IAS 1, which specifically requires that an enterprise should present a statement of changes in equity as separate components of its financial statements. Moreover, Appendix to the IAS 1 illustrates the minimum requirements of IAS for presentation of statement of changes in equity. This statement is obligatory as it reflects the increase or decrease in the net assets or wealth of an enterprise between two balance sheet dates. It is nothing but gross carelessness of the auditor to report on a statement, which was never audited and not attached to the accounts. It is also to be noted that Para 7 of IAS 1 referred by the auditors deals with the components of the financial statements whereas Para 86 of IAS is relevant, which requires disclosure to made in the financial statements. The argument of the auditor on this account is, therefore, not sustainable. The contention that the Company has

ceased operations also does not advance the cause of auditor because of the simple reason that the Auditors are required to report in accordance with the statutory mandatory provisions and Standards irrespective of whether the company is operational or not. The contention that carrying value of fixed assets approximates their book value as reflected in financial statements is also not understandable as the Company is closed since 1996 and no depreciation has been charged on the fixed assets of the Company. In this regard, I would like to refer to Para 64(e) of IAS 16 which specifically requires that carrying value of each class of revalued assets should also be disclosed at cost less accumulated depreciation. As regard to the non-disclosure of number of employees, Mr. Arshid Rathor did not press any reason for the same. The other main issue in this case is that the Auditor has failed to make appropriate modification in the opinion paragraph of his report to reflect his qualifications. Auditing Standards 13 provides the circumstances when the auditor needs to issue modified reports and the illustration of the modified reports in different circumstances. The requirements of this Auditing Standard, however, were not followed by the auditor while issuing his report on the accounts of the Company. In view of the aforesaid discussion, I am of the view that the audit report on the accounts of the Company for the year ended June 30, 2001 has been made otherwise than in conformity with the requirements of Section 255 of the Ordinance, is otherwise untrue and contained incorrect statement. The aforesaid violations are very serious, which cannot be encouraged.

11. In view of the foregoing, the undersigned is convinced that an action against the Auditor is necessary. As the auditor has not been able to give any justifiable excuse for the violations, therefore, I consider it a deliberate act on the part of Mr. Phinehas Salamat who was under legal obligation to perform his duties, in the course of audit of Accounts of the Company and reporting

thereon, in accordance with the provisions of the Ordinance, International Accounting Standards and Auditing Standards.

12. For the reasons stated above, I impose a fine of **Rs 2,000** (Rupees two thousand) on Mr. Phinehas Salamat under Sub-section (1) of Section 260 of the Ordinance read with Section 476 of the Ordinance.

13. I impress upon Mr. Phinehas Salamat to perform his duties with a reasonable degree of care and skill in future. It is his responsibility to put in place the requisite quality control policies and procedures to ensure that audit is conducted in accordance with the applicable financial reporting framework.

14. Mr. Phinehas Salamat is directed to deposit the above stated fine in the Bank Account of Securities and Exchange Commission of Pakistan maintained with Habib Bank Limited within 30 days of the date of this Order and furnish a receipted challan to the Securities and Exchange Commission of Pakistan.

RASHID SADIQ
Executive Director (Enforcement & Monitoring)

Announced
June 11, 2002
ISLAMABAD