SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement and Monitoring Division

[Islamabad]

Before Rashid Sadiq, Executive Director

Order

In the matter of
MR. ASRAR UL MAJID KHAN, FCA

[UNDER SUB-SECTION (1) OF SECTION 260 READ WITH SECTION 255 AND SECTION 476 OF THE COMPANIES ORDINANCE, 1984]

Number and date of notice	EMD/C.O.258/75/2002-3532 November 27, 2002
Date of hearing	January 24, 2003
Present	Mr. Asrar-ul-Majid Khan, FCA
Date of Order	June 24, 2003

This Order shall dispose of the show cause proceedings initiated against Mr. Asrar-ul-Majid Khan under Section 260 of the Companies Ordinance, 1984 (the "Ordinance") for his negligence in the performance of his duties while conducting audit of accounts and books and account of M/S Wali Oil Mills Limited (hereinafter referred to as the "Company") and making audit report otherwise than in conformity with the requirements of Section 255 of the Ordinance.

2. Mr. Asrar-ul-Majid Khan is a Fellow Member of the Institute of Chartered Accountants of Pakistan (the "ICAP') and was registered with ICAP on February 10, 1968 under Registration Number 447. He is a practicing Chartered Accountant and is conducting his business under the name and style of "Arman & Co., Chartered Accountant" at 164/6 Shadman, Lahore.

3. The facts leading to this case, briefly stated, are that M/S Arman & Co., Chartered Accountant was appointed as Auditor of Company in its Annual General Meeting held on December 31, 2001 to hold office from the conclusion of the said meeting until the conclusion of next Annual General Meeting. The audit was conducted and Mr. Asrar-ul-Majid signed audit report to the members of the Company on September 30, 2002.

4. The Enforcement and Monitoring Division conducted an examination of the financial statements of the Company for the year ended June 30, 2002 (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 Accounts revealed that the Company has classified an amount of Rs.8.15 million as deferred revenue expenditure contrary to the requirements of the Clause (B) of Para 5 of Part II of the 4th Schedule to the Ordinance. It has also been noticed from the Accounts of the Company that amortization of deferred revenue expenditure amounting to Rs.6.042 million has been shown as inflow from investing activities in Cash Flow Statement contrary to the requirements of Para 43 of IAS 7 which provides that investing or financing transactions that do not require the use of cash or cash equivalents should be excluded from a cash flow statement.

6. It was also observed that cash generated from financing activities regarding long term loans has been shown as Rs.101.899 million in cash flow statement for the year ended June 30, 2002 which is not substantiated from the loan figures appearing in notes 4 and 5 to the accounts. Moreover, this presentation in cash flow statement is against the requirements of Clause (c) and (d) of Para 17 of International Accounting Standard 7, which provide that cash proceeds and cash payments should be disclosed separately.

7. It was also observed from the Accounts that the management has reported in Note 22 to the Accounts that response to balance confirmation letters sent to all the debtors and creditors was poor. The auditor, however, has not modified his opinion in the audit report.

8. The examination of the Accounts further revealed that the Company has not observed the requirements of the following International Accounting Standards (IAS) and Fourth Schedule to the Ordinance in regard to the accounts and preparation of the Balance Sheet and Profit and Loss Account for the year ended June 30, 2002:

- Disclosures of Staff retirement benefits as per requirements of International Accounting Standard –19 (Retirement Benefits).
- Disclosure of effective interest rate as per Clause (b) Para 56 of IAS 32; Financial Instruments: Disclosure and Presentation.
- Disclosure of number of employees as per Clause (d) of Para 102 of IAS 1 (Presentation of Financial Statements).
- Disclosure of Earnings per Share in the accounts as per Para 47 of IAS 33; Earnings Per Share.
- Disclosure of Corresponding figures of Financial Instruments and Related Disclosures in as per requirements of Para 38 of IAS 1.
- Disclosure regarding Long Term Loans as required in Sub-para (E) of Para 8 of Part of II of the 4th Schedule.
- Disclosure regarding Loan from Directors and Associates as required in Sub-para (E) of Para 8 of Part of II of the 4th Schedule to the Ordinance.
- Disclosure of penalties imposed on the Company by the Commission as per Para 4 of Part 1 of the 4th Schedule of the Ordinance.
- Disclosure regarding mark-up on loans as per Clause (ii) of Para G of Part III of the 4th Schedule of the Ordinance.
- The nature of bank accounts as per Clause (xii) of Para 6 of Part II of the 4th Schedule of the Ordinance.

- Reasons for low output have as per the Clause (vii) of Para 2 of Part I of 4th Schedule to the Ordinance.

9. Mr. Asrar-ul-Majid Khan, the Auditor of the Company, however, has not drawn attention of the members towards the aforesaid non-disclosures in his Audit Report signed on September 30, 2002 and instead has given an opinion that the balance sheet, profit and loss account together with the notes thereon have been drawn up in conformity with the Ordinance.

10. In view of the above circumstances, the Enforcement Division felt concerned about the quality of audit of the Company conducted by Mr. Asrar-ul-Majid Khan and report made by him on the Accounts. 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 was otherwise untrue and contained a statement, which was materially incorrect.

11. Consequently a notice dated November 27, 2002 was issued to Mr. Asrar-ul-Majid Khan to show cause as to why action may not be taken against him for the contraventions of the mandatory provisions of law. The reply to the show cause notice was received through letter dated December 24, 2002. In order to provide an opportunity of personal hearing, the case was fixed on January 24, 2003. Mr. Asrar-ul-Majid Khan appeared at the time of hearing and argued the case.

12. The arguments put forward by Mr. Asrar-ul-Majid Khan in his written reply and at the time of the hearing with regards to the issues raised in the notice are as follows:

- Deferred revenue expenditure couldn't be charged to Profit and Loss Account as it consisted of future financial charges of leases and heavy expenditure on advertisement whose benefit will accrue in future.

- As regard to inclusion of amortization of deferred revenue expenditure in cash flow statement it was contended that the difference between opening and closing balance of deferred revenue expenditures amounting to Rs. 6.042 million has been shown, as inflow from investing activities and Para 43 of IAS 7 was not applicable in the case.

- Accrued markup of Rs. 5.620 million has been deducted to arrive at increase in increase long-term loans. However, it was admitted that incorrect classification was made in the accounts and that accrued mark up should have been disclosed in creditor, accrued and other liabilities.

- As regard to poor confirmation of debtors and creditors it was sated that there was no need to modify the report as alternative procedures were performed to verify the balances.

- Since the Company has no staff retirement plan, therefore, IAS 19 was not applicable.

- Disclosure of Earnings Per Shares was restricted to the company whose shares are publicly traded on the stock exchange.

- IAS 32 was not applicable, as the company has not issued any financial instrument.

As regards to other deficiencies in disclosure requirements, Mr. Asrar-ul-Majid Khan accepted that certain deficiencies as pointed out in the show cause notice occurred due to omission and printing errors. He regretted the deficiencies and pleaded for a lenient view of the default.

13. Having heard Mr. Asrar-ul-Majid Khan and after examination of the relevant provisions of law and the perusal of the record of this case, I am of the opinion that the arguments advanced by him are totally unsatisfactory and untenable. In respect of Deferred Revenue Expenditure, the factual position is that future financial charges are required to be deducted from the minimum lease payments to arrive at present value of

minimum lease payments as per IAS 17. As such the inclusion of future financial charges as deferred revenue expenses is against the requirements of the Clause (B) of Para 5 of Part II of the 4th Schedule to the Ordinance which provides that deferred costs shall include preliminary expenses, discount allowed on the issue of shares, if any, and expenses incurred on the issue of shares including any sums paid by way of commission or brokerage on the issue of shares. The contention that difference between opening and closing balance of deferred revenue expenditure has been shown as inflow from investing activities is against general accepted accounting principles which requires that only cash transactions should be disclosed in cash flow statement. This is also against the requirements of Clause (c) and (d) of Para 17 of International Accounting Standard 7, which require that cash proceeds and cash payments should be disclosed separately. As regards inconsistencies in the amount of long-term loan, Mr. Asrar-ul-Majid has accepted that accrued mark-up was included in long-term loan, which should have been shown separately. As a result of inclusion of non-cash transactions and misstatement of amount of long-term loan repaid, the cash flow statement does not give a true and fair view of the state of affairs of the Company whereas Mr. Asrar-ul-Majid Khan certified in his report to the contrary. The audit report signed by Mr. Asrar-ul-Majid Khan, therefore, was otherwise in conformity with the requirements of Section 255 of the Ordinance.

14. Mr. Asrar-ul-Majid Khan could not give any justification as to why he has not modified his report to the members on the statement of the management in the notes to the accounts that results of confirmation of debtors and creditors were poor. Para 31 of Auditing Standard 505 (External Confirmation) provides that the auditor should perform alternative procedures where no response is received to a positive external confirmation request. The alternative audit procedures should be such as to provide the evidence about the financial statement assertions that the confirmation request was intended to provide. Para 30 of Auditing Standard 13A –The Auditors' Report on Financial Statements requires that in certain circumstances, an auditors' report may be modified by adding an emphasis of matter paragraph to highlight a matter affecting the financial statements, which is included in a note to the financial statement that more extensively discusses the matter. Mr. Asrar-ul-Majid

Khan has not followed these procedures. His statement in the audit report that he has conducted audit in accordance with the applicable auditing standards, therefore, in incorrect. His contention that requirement of IAS 19 is not applicable as the Company had no staff retirement plan is not sustainable as the Company has disclosed amount payable to Provident Fund in the Accounts. The Company, therefore, has some staff retirement plan which needed to be disclosed as per requirements of IAS 19. His argument that Disclosure of Earnings Per Share was restricted to the companies whose shares are traded on the stock exchange is also not sustainable as the listed companies are required to give disclosures as required under the law even if there is no trading of their shares on Stock Exchanges. As regard to non-disclosure of financial instruments as per IAS 32, the reply is totally unsatisfactory as the disclosure was found missing in the Accounts. The argument that the deficiencies in the Accounts were due to printing errors is also not well founded because of the simple reason that the same deficiencies were also found in the accounts signed by Mr. Asrar-ul-Majid Khan, which were filed with the Commission. Further, the similar deficiencies were found in the Accounts of the Company for the year ended June 30, 2001 for which he was also penalized in the past. It is, thus, abundantly clear from the above discussion that the auditor has failed to perform his statutory obligations by not giving fullest information to the members. It was incumbent on the Auditor to have drawn attention to the members of the Company towards the non-compliances/contraventions in his Audit Report. In the circumstances, it is clear that the Auditor has failed to perform his duties with reasonable degree of care and skill. In view of the above, I have reached the conclusion that the audit report signed by Mr. Asrar-ul-Majid Khan was otherwise than in conformity with the requirements of Section 255 of the Ordinance and his statements therein were untrue.

15. After careful consideration of the conduct of the auditors of the Company and the particular circumstances of this case, I am of the view that no justice would be done to issue warning only as pleaded by Mr. Asrar-ul-Majid Khan during the course of hearing of this case. As the Auditor has admitted the defaults and has not been able to give any

justifiable excuse for the same, therefore, I consider it a deliberate act which is certainly more than mere omission and default on the part of Mr. Asrar-ul-Majid Khan 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. Mr. Asrar-ul-Majid Khan has, therefore, made himself liable for punishment under Sub-section (1) of Section 260 of the Ordinance. It is also considered intentional because of the reason that he could not improve his performance in spite of the fact he was penalized in the past for similar negligence in respect of the audit of this Company for the year ended June 30, 2001.

16 In view of the above and after considering all the circumstances of this case and after perusing the material placed on record, I am of the view that Mr. Asrar-ul-Majid Khan is liable for punishment under Sub-section (1) of Section 260 of the Ordinance. I, therefore, impose a fine of Rs.2,000 (Rupees two thousand) under Sub-section (1) of Section 260 read with Section 476 of the Ordinance on Mr. Asrar-ul-Majid Khan, FCA.

17. Mr. Asrar-ul-Majid Khan is directed to deposit the fine of Rs. 2,000 (Rupees two thousand) 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.

18. Mr. Asrar-ul-Majid Khan, FCA was also penalized in the past for his gross negligence in the performance of his duties as auditor of this Company for the year ended June 30, 2001 and his case was also referred to ICAP at that time. A copy of this Order may also be sent to President, ICAP for his information and necessary action in accordance with the provisions of the Chartered Accountants Ordinance, 1961.

RASHID SADIQ
Executive Director (Enforcement & Monitoring)

Announced
June 24, 2003
ISLAMABAD