



Securities and Exchange Commission of Pakistan
(Enforcement & Monitoring Division)

[Islamabad]

Before Rashid Sadiq, Executive Director

Order

In the matter of

M/S SHAHID SAMI & CO., CHARTERED ACCOUNTANTS

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

Number and date of show cause notice	EMD/233/552/2001 Dated: November 11, 2002
Date of hearing	June 30, 2003
Present	Mr. Asif Ahmed Mian, FCA Mrs. Quaratullain Hadi, ACA
Date of Order	June 30, 2003

This order shall dispose of the proceedings initiated under Section 260 of the Companies Ordinance, 1984 (hereinafter referred to as the “Ordinance”) against the partners of M/s Shahid Sami & Company, Chartered Accountants (hereinafter referred to as the “Auditors”) for making report to the members of M/s Gammon Pakistan Limited (hereinafter referred to as the “Company”) on the accounts and books of accounts and balance sheet and profit and loss account otherwise than in conformity with the requirements of section 255 of the Ordinance.



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2. M/S Shahid Sami & Co., is a partnership firm and the partnership comprises of Mr. Abdul Hadi Shahid, FCA, Mr. Syed Saifullah, FCA, Mr. Asif Ahmed Mian, FCA and Mr. Saiyed Enayet Hussain, FCA. All these partners are practicing members of the Institute of Chartered Accountants of Pakistan (the “ICAP”).

3. In order to fully appreciate the issues involved in this case brief narration of the background facts is necessary. M/S Shahid Sami & Co., has audited the accounts and books of accounts of the company and has made audit report on the financial statement of the Company for the year ended June 30, 2002 (the “Accounts”). The said report was signed on September 08, 2002.

4. The Enforcement & Monitoring Division conducted an examination of the financial statements of the Company for the year ended June 30, 2002 to determine, among other things, whether auditors report pertaining to the aforesaid financial year had been made in conformity with the requirements of Section 255 of the Ordinance, is otherwise true, contains no such statement which is materially false and there is no omission of material facts about the affairs of the company.

5. The aforesaid examination revealed the following deficiencies and irregularities in the accounts:

- (i) The auditors had drawn emphasis on the contingent liabilities discussed at note 9 (B) (i) & (ii) of the accounts stating that the company had not provided for the contingencies as stated therein. But no clear description of all substantive reasons or quantification of the possible effects on the financial statements was given in the report, as required by Para 40 of AS 13.



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- (ii) In note 5.1 to the accounts, it has been stated that interest on long-term loans has been provided up to June 30, 2001. However, the company has not made provisions for the year ended June 30, 2002, which is against the requirements of para 22 of framework to the International Accounting Standards and clause (i) of para (2) of part 1 of the 4th Schedule of the ordinance.
- (iii) Statement of changes in equity has been included in the notes to the aforesaid accounts contrary to the requirements Para 7 of International Accounting Standard (IAS) 1 (Presentation of Financial Statements), which requires that separate statement of changes in equity shall be a separate component of the financial statements.
- (iv) The Company has disclosed Rs. 27.31 million as deferred contract cost contrary to the requirements of the 4th Schedule to the Ordinance and IAS 11 and Clause (b) of Para 32 of IAS 11 (Construction Contracts).
- (v) It was also observed from the perusal of the accounts that following disclosure requirements of the International Accounting Standards (IAS) and Fourth Schedule to the Ordinance were not followed in regard to the Accounts and the preparation of the balance sheet and profit and loss accounts of the company:
- a. The method for determination of stage of completion of the construction contracts has not been disclosed as per Clause (c) of Para 39 of IAS 11; Construction Contracts.
 - b. No disclosures of Staff retirement benefits according to Para 120 of International Accounting Standard –19 (Employees Benefits).
 - c. Disclosure of effective interest rate has not been made in the accounts contrary to requirements of Clause (b) Para 56 of IAS 32; Financial Instruments: Disclosure and Presentation.
 - d. Earning per Share has not been disclosed in the accounts as per Para 47 of IAS 33 (Earnings Per Share).
 - e. Disclosures regarding Joint Ventures the Company had entered into, (Note 2 (b) of the accounts) are inadequate which constitutes contravention with Para 45 to 47 of IAS 31; Financial Reporting of Interest in Joint Ventures.
 - f. The carrying amount of each class of revalued property, plant and equipment that would have been included in the financial statements had the assets been carried at cost less accumulated depreciation has not been disclosed as per Para 64 (e) of IAS-16-Property, Plant and Equipment.
 - g. Disclosure of Long Term Loans is not appropriate with regards to terms & conditions of and period of repayment as required in Clause (b) & (d) of Sub-para (E) of Para 8 of Part of II of the 4th Schedule.
 - h. Surplus realized on the sale of revalued assets has been offset against the loss relating to prior years in contravention with the requirements of Para 34 (b) of IAS 1 – Presentation of Financial Statements.



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- i. Surplus realized on the sale of revalued assets has been shown as part of the Profit and Loss Account contrary to the requirements of Para 39 of IAS 16 – Property, Plant and Equipment.
- j. The disclosure regarding the period within which the mark-up or repurchase price is to be repaid has not been made in respect of Short Term Finances, which shows non-compliance of Clause (ii)(a) of Para 12B of Part II of the 4th Schedule to the Ordinance.
- k. The amount of reduction or increase in the value of the revalued assets and the name and qualification of the valuer have not been disclosed as per Clause (C) of Para (2) of Part II of the 4th Schedule to the Ordinance

6. In view of the above the Enforcement and Monitoring felt concerned regarding the quality of audit of the company conducted by the auditors of the Company and the audit report made by them on the accounts of the Company for the year ended June 30, 2002.

7. Consequently a show cause notice was issued to all the partners of M/s Shahid & Sami Company on November 11, 2002 pointing out their responsibilities under the Ordinance, International Accounting and Auditing Standards and non-compliance observed in the Accounts. A period of 14 days was given to respond to the aforesaid notice. No reply was received within the specified time period. Subsequently the auditor sought extension of further two weeks but was advised to submit reply up-till January 11, 2003. The reply was finally received on January 09, 2003. In order to provide opportunity of personal hearing, the case was fixed on June 30, 2003. Mr. Asif Ahmed Mian, FCA and Mrs. Quaratullain Hadi, ACA appeared before me at the time of hearing and argued the case.



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8. In the submissions in writing and at the time of the hearing, it was contended that although there were a few error and omissions in disclosure given in the accounts of the Company but none of them were such so as to render the financial statements untrue and misleading. In order to determine the truth of the matter the submissions of the auditors against the issues raised in the show cause notice are discussed in the following paras:

- (a) On the issue regarding non-provision of mark-up on long term loans, it was contended that the Bank had principally decided to write off the loan and only formal documentation for write off was pending. In this regard replies of two different branches of Citi Bank N.A. were placed before me, one showing NIL balance and other stating that the subject company was not maintaining account with them. After hearing the submissions of the auditors and examination of the record placed before me, I find the contention totally baseless and frivolous. To fully comprehend this issue, it is pertinent to examine the information regarding the long term loan provided in the accounts of the Company. In this regard the relevant disclosure can be found in Note 5 – Long Term Loans:

“5.1) This represents the balance of the overdraft due to Citibank N.A including interest thereon which had been converted into long-term loan. Interest has been provided up to June 30, 2001. This loan is secured by first charge on the present and future plant, machinery, equipment, materials, stores, spare parts and other movable assets as well as all receivables and mortgage on certain immovable properties. This loan as sanctioned carried interest @ 14% per annum.

5.2) Under a financial restructuring package the company has linked the repayment of long term loan and interest thereon with the bonding assistance made available by the bank in 1988-89 but discontinued by the bank for the last several years.

5.3) In the absence of bank statements and confirmations letters, the balance remained unconfirmed as at the balance sheet date.”

Firstly the disclosure regarding the repayment of the loan is ambiguous as it is stated that the company has linked the repayment with the bonding assistance made available by the Bank, however, it is not clear as to whether the bank has agreed with such an arrangement. Secondly and more importantly it has been disclosed that the loan balance remained unconfirmed. ISA 505 – External confirmations in para 16 provides that:

“When obtaining evidence for assertions not adequately addressed by confirmations, the auditor should consider other audit procedures to complement confirmation procedures.”



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Moreover, in view of the quantum of the amount of the loan of Rs. 26.531 million against paid up capital of Rs. 35.00 million, it was incumbent on the auditor to have adopted alternative procedures to verify the factual position in this regard. However, no indication of performing any alternative procedure has made and inspite of this the auditors has not drawn the attention of the shareholders to this fact in his report on the accounts of the Company for the year ended June 30, 2002. In contradiction with the disclosure in the aforesaid note it was contended at the time of the hearing that balance confirmation indicating NIL balance was received from the bank. The situation becomes all the more alarming as the balance confirmation letter placed before me does not pertain to the loan account of the Company as this has been addressed to a branch of the bank where the Company was not maintaining an account. In view of the above discussion and the contradictory submissions of the auditors in respect of the disclosure in the accounts of the Company for the year ended June 30, 2002, I am of the view that the accounts do not present a true and fair of the affairs of the Company and the auditors have failed to audit the accounts in accordance with the applicable auditing standards.

- (b) In reply to the query regarding the classification of contract cost as deferred expense by the company in contravention with the requirement of the 4th Schedule to the Ordinance and IAS 11, it was submitted that capitalized contract cost represented 50% percent of the cost actually incurred on the project (note 14) because as per the terms and conditions of the contract 75% of the costs incurred are recoverable from the party to whom the contract would subsequently be awarded. The management of Company being prudent has only deferred 50% of the cost instead of the entire 75%. In this regard para 27 of IAS 11 has also been referred, which states that contract cost incurred relating to future activity on the contract should be recognized as an asset provided that it will be recovered. The important point to note in the afore-referred para is the possible recovery of the costs incurred. In the case at hand the contract has already been cancelled since 2001 and the Company already has expensed out 50% of the contract costs, therefore, there are doubts regarding the recovery of these costs. The classification of these costs as an asset cannot be justified. In this regard, it is necessary to look at the disclosure provided in the balance sheet, which is as follows:

	2002 Rupees	2001 Rupees
<i>Deferred Contract Costs</i>	<i>Rs. 27,304,791</i>	<i>Rs. 15,331,423</i>

Year June 30, 2001

Note 11. Deferred Contract Cost

Islamabad-Peshawar Motorway contract of M/S Bayindir was cancelled by N.H.A. on April 23, 2001 resulting in suspension of our work. Hence cost associated with the work, which was yet to be done, has been deferred and will be absorbed in the cost of balance work of the project.

Accounting Policy for Deferred Contract Cost-Note 2.9

Heavy expenditure on temporary accommodation, form work, consumable materials, tools and auxiliary works are charged off to contracts under execution over their completion period according to a consistently followed method.



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Note 14. Deferred Contract Cost

Islamabad-Peshawar Motorway contract of M/S Bayindir was cancelled by N.H.A. on April 23, 2001 resulting in suspension of our work. Hence the costs including direct and indirect costs associated with the work, which is yet to be done has been deferred and will be absorbed in the cost of balance work of the project, if and when executed by the company.

Accounting Policy for Deferred Contract Cost-Note 2.9

Heavy expenditure on temporary accommodation, form work, consumable materials, tools and auxiliary works are charged off to contracts under execution over their completion period according to a consistently followed method.

The aforesaid accounting policy clearly indicates that the costs associated with the contracts can be deferred only in respect of contracts under execution. In this case the contract was cancelled on April 23, 2001 and these costs should have been expensed out. It has been argued by the auditors that capitalized contract cost represented 50% percent of the cost actually incurred on the project because as per the terms and conditions of the contract 75% of the costs incurred are recoverable from the party to whom the contract would subsequently be awarded. The management of Company being prudent has only deferred 50% of the cost instead of the entire 75%. In my view, firstly there appears to be no firm commitment with N.H.A. that 75% of the cost incurred by the Company would be recovered, which is also clear from the Directors Report for the year ended June 30, 2002, the relevant para is reproduced hereunder:

“It is pertinent to note that while the company and other sub contractors of Bayindir (BCI) are of the firm opinion that they are entitled to complete the balance of work sub contracted to them by BCI. *NHA had only indicated in the tender documents that “ the firms engaged by BCI as sub-contractors before expulsion may preferably be considered by the successful bidders for engagement as sub contractors.....”* The tender documents also provide for “ Advance for payment of seventy five (75) percent of the outstanding dues of BCI affectees.....verified and approved by the employer....” In this context the employer shall be NHA. The Company’s bills for work done have been certified by BCI. The claims of the company recoverable from BCI are separate and will be agreed with BCI”.

Further more, if the management was certain about the recovery of the said amount, this amount should have been shown as recoverable and not as deferred cost. Following extract of Para 34 of IAS 11, clearly spells out the circumstances in which recoverability of the contract costs incurred may not be probable and costs may need to be recognized as an expense immediately

“ Contract costs that are not probable of being recovered are recognized as an expense immediately. Examples of circumstances in which the recoverability of contract costs incurred may not be probable and in which contract costs may need to be recognized as an expense immediately include contracts:

- (a) which are not fully enforceable, that is, their validity is seriously in question;
- (b) the completion of which is subject to the outcome of pending litigation or legislation;
- (c) relating to properties that are likely to be condemned or expropriated;
- (d) where the customer is unable to meet its obligations; or



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- (e) where the contractor is unable to complete the contract or otherwise meet its obligations under the contract.

It is apparent that the Company has not followed the requirement of IAS while classifying these costs as deferred costs. Furthermore the amount, related to the cancelled contract, charged to the Profit and Loss Account by the Company has not been disclosed separately on the contrary it has been grouped under the head of contract expenditure. Separate disclosure was all the more necessary keeping in view the requirement of Clause (i) of Para (2) of Part I of the fourth schedule to the Ordinance, which requires disclosure of all material information necessary to make the financial statements clear and understandable. In view of the above discussion, I am of the opinion that the balance sheet and profit and loss account do not present a true and fair view of the state of affairs of the Company. On the contrary the auditors report states that the accounts give a true and fair view of the state of affairs of the Company.

- (c) As regards the issue that the audit report on the accounts was not properly made out and a reference at end of the report has been made to the notes regarding contingencies without specifying as to whether or not the report is modified. In reply the auditors submitted that no qualification is provided in the audit report, however, the opinion has been modified because of uncertainties, the outcome of which depends on future actions or events not under direct control of the entity as per para 32 of IAS 13. However, the auditor have failed to note that para 33 of IAS 13 provides an illustration of emphasis of matter paragraph for a significant uncertainty in an auditors' report, which is as follows:

“Without qualifying our opinion we draw attention to Note X to the financial statements. The Company is a defendant in a lawsuit alleging infringement of certain patent rights and claiming royalties and punitive damages. The Company has filed a counter action.....”

In the absence of the words *without qualifying* the report of the auditors as has been issued is ambiguous and reader cannot infer any meaningful information from it about that the state of affairs of the Company.

9. My views are further strengthened from the management letter dated August 31, 2002 of the auditor addressed to the Managing Director, a copy of which was placed on record during the course of hearing. The perusal of the management letter makes it evidently clear that the auditor has raised most of the issues discussed above in the management letter to Managing Director of the company. It is pertinent to state that no reply was made by the management of the company in writing in response to the management letter. However auditors have failed to bring these issues to the notice of the shareholders of the



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company contrary to the requirements of International Auditing Standards. Relevant Observations, apart from various other pointing out inadequate disclosures & inconsistencies in the accounts, are reproduced hereunder:

Deferred Costs

- (a) Gammon Pakistan Limited has incurred cost of Rs.20,011,730/- on the project shown as deferred costs in the Balance Sheet. The raw material equipments and tools were lying on site since last two years and no provision for obsolescence was made. Further that we believe that the market value of the items on site must have been depreciated over the period thereof such costs should be amortized on reasonable basis.
- (b) During the audit we observed that management has charged head Office expenditure of Rs. 5,288,294/- to deferred cost account.

Long Term Loan

- (a) We observed that the company was not providing any interest on Citi Bank N.A loan.
- (b) We have not received any confirmation during the year. But reply to our last year confirmation was marked "NIL" by the bank and accordingly we pointed out the same in the accounts.

Severity and materiality of the issues pointed out by the auditors to the management of the company in the management letter were required to be reported to the shareholders, which was not done by the auditor.

10. As regard to the other issues raised in the show cause notice, Mr. Asif Ahmed Mian, FCA admitted the default in most of the issues and pleaded for a lenient view on the assurance that such defaults would not be repeated. He was submitted that Mr. Saiyed Enayat Hussain, FCA was the engagement partner for the audit of the Company and had signed the audit report on the accounts of the Company for the year ended June 30, 2002. He pleaded a lenient view citing the fact the M/s Shahid Sami



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& Co. have resigned as auditors of the Company and that Mr. Saiyed Enayat Hussain, FCA will resign as partner of the firm and will handover his practicing license to the ICAP.

11. Before deciding this case, I deem it necessary to make some observations on the role of auditors of a company. The auditors being the ultimate watchdog of the shareholders interest are required to give a report on the accounts and books of account after conducting the audit in accordance with the prescribed procedures and requirements of the Ordinance, International Accounting and Auditing Standards. If they find any irregularity, which is material with regard to those accounts, they are required to issue a modified report. The shareholders are the ultimate entity to whom the auditors are responsible and they must keep this fact in mind while auditing the books of accounts and reporting thereon. It has, however, been noticed in several cases that auditors are not performing their statutory duties with due care and in accordance with the legal requirements. They must realize their true role and restrain themselves from performing their duties indulgently.

12. The duties and responsibilities of an auditor appointed by the shareholders under Section 252 of the ordinance can best be understood if we look at the place of an auditor in the scheme of the company law. The capital required for the business of a company is contributed by its shareholders who may not necessarily be the persons managing the company. In the case of a listed company, the general public also contributes towards the equity of the company. Such persons do not have any direct control over the company except that they elect directors for a



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period of three years and entrust the affairs of the company to them in the hope that they will manage the company to their benefits. The shareholders are, therefore, the stakeholders and the ultimate beneficiaries. Practically, however, the shareholders have no control over the way their company is managed by the directors appointed by them. It was, therefore, necessary that there must be some arrangement in place whereby the shareholders who are the real beneficiaries must get some independent view as to how the directors have managed the affairs of the company. The law, therefore, recognizing this situation, has provided that the shareholders should appoint an auditor who shall be responsible to audit the accounts and books of account and make out a report to them at the end of each year. This is the only safeguard provided by law to the shareholders to ensure that the business is carried on by the directors in accordance with sound business principles and prudent commercial practices and no money of the company is wasted or misappropriated. The law, therefore, make the auditors responsible in case the fail to make out a report in accordance with the legal requirements. It is, therefore, extremely important for the auditors to be vigilant and perform their duties and obligation with due care while auditing the accounts and books of accounts.

13. It is 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 to the members. In the circumstances, it is clear that



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the Auditor has failed to perform his professional duties with reasonable degree of care and skill. He knowingly and recklessly ignored his observations and gave a clean bill of health to the Company's accounts.

14. As the Auditor has admitted the defaults and has not been able to give any justifiable argument for the same, therefore, I consider it a deliberate act which is certainly more than mere omission and default on the part of Mr. Saiyed Enayat Hussain, FCA 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. Saiyed Enayat Hussain, FCA has, therefore, made himself liable for punishment under Sub-section (1) of Section 260 of the Ordinance. As regards the practicing license of Mr. Saiyed Enayat Hussain, FCA, I am of the view that since ICAP is the issuing authority, therefore, any decision of the revocation or otherwise of the same can only be taken by it.

15. For the reasons stated above, I impose a fine of Rs. 2,000/- (Rupees two thousand) under Sub-section (1) of Section 260 of the Ordinance on Mr. Saiyed Enayat Hussain, FCA, for making report otherwise than in conformity with the requirements of Section 255 of the Ordinance on the financial statements of the Company for the year ended June 30, 2002. As has already been discussed earlier, Mr. Saiyed Enayat Hussain, FCA, was the engagement partner for the audit of the



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Company; therefore, no fine is imposed on Mr. Abdul Hadi Shahid, FCA, Mr. Asif Ahmed Mian, FCA and Syed Safiullah, ACA.

16. Mr. Saiyed Enayat Hussain, FCA, 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.

17. 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 and Monitoring)

Announced
June 30, 2003
ISLAMABAD