Before Tahir Mahmood – Commissioner (Company Law Division)

In the matter of

Aftab Nabi & Co., Chartered Accountants - Auditor of Pakistan Footwear Manufacturers Association

Number and date of notice:	ARN/173/2015-136 dated July 13, 2015
Date of hearings:	September 7, 2015
Present:	Aftab Ahmed, Aftab Nabi & Co., Chartered Accountants

ORDER

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

This order shall dispose of the proceedings initiated against the engagement partner of Aftab Nabi & Co, Chartered Accountant, (the "respondent"), the statutory auditor of Pakistan Footwear Manufacturers Association (the "Company") for the year ended June 30, 2013. These proceedings were initiated through show cause notice ("SCN") dated July 13, 2015 under the provisions of section 260 read with sections 255 and 476 of the Companies Ordinance 1984 (the "Ordinance").

2. The brief facts of the case are that the respondent conducted the audit and signed the auditor's report dated July 27, 2013 on the financial statements (the "Accounts") of the Company for the year ended June 30, 2013. The said auditors' report did not appear to have been drawn out in conformity with the requirements of section 255 of the Ordinance and International Standards on Auditing ("ISAs"), as the respondent, prima facie, failed to modify his report and opinion with regard to the following non-compliances observed in the Accounts:

- ✓ The Company has prepared Income and Expenditure Account on cash basis instead of accrual basis, as disclosed under note 2.2 to the Accounts, in contravention with the requirements of Para 27 of International Accounting Standard ("IAS") 1-*Presentation of Financial Statements.*

- ✓ Despite being a company other than an MSE or an SSE, the Statement of Compliance provided in note 2.1 to the Accounts, is not in accordance with the requirement of Circulars 7/2007 *(applicable to companies other than MSEs and SSEs)* dated November 2, 2007 issued by the Institute of Chartered Accountants of Pakistan ("ICAP"). Instead of giving a specific statement about the reporting framework used to prepare the Accounts, it contained a rather generalized statement that *these financial statements have been prepared in accordance with Accounting Standards as applicable in Pakistan under the Companies Ordinance, 1984.........continued*; and

- ✓ The Statement of Changes in Funds has not been prepared and annexed to the Accounts in contravention with requirements of IAS 1 and, therefore, has not been audited by the respondent.

It also transpired that the respondent signed and stamped the Accounts against the requirements of ICAP's Circular No. 4 of 1999 dated June 17, 1999 which states that *the financial statements of an enterprise should not be stamped or signed by the auditors unless there is a statutory requirement to do so.* Consequently, the SCN was issued to the respondent under section 260 read with sections 255 and 476 of the Ordinance.

3. In response to the SCN, the respondent submitted reply vide letter dated July 15, 2013, which was received on July 28, 2015. A brief of his submissions with reference to the contents of the SCN is given below:

- Object of the Company: It is reiterated that the Company is trade association registered under section 42 of the Ordinance and is responsible for arranging seminars and exhibition for footwear industry. It is a non-profit organization and is not run commercially.
- Income & Expenditure Accounts: The Company is not involved in the business activities, therefore, all expenses are incurred on cash receipt basis, however, the Company will look into this matter and shall book income or expenses, if any, on accrual basis in future. The mistake may please be condoned.
- Statement of Compliance: Correction has been made in the financial statements for the year 2014 by stating in the Compliance Statement, as under:
  "These financial statements have been prepared in accordance with approved accounting standards which comprise of accounting and financial reporting standards as required by the Guideline for Non-Government Organizations (NGO) / Non-Profit Organizations (NPOs) issued by the Institute of Chartered Accounts of Pakistan and provisions of and directives issued under the Companies Ordinance, 1984. In case requirements differ, the provisions or directives of the Companies Ordinance, 1984 shall prevail."

The mistake is unintentional and may please be condoned

- Statement of Changes in Funds: Failure to attach statement of changes in funds is unintentional and may please be condoned. Statement of Changes in Funds was prepared and submitted for your record and perusal vides our previous letters.

Based on the above submissions the respondent requested for a lenient view and requested to drop the proceedings.

4. The case was fixed for hearing on September 7, 2015 and the respondent appeared before the undersigned on the appointed date. He made verbal submissions mainly reiterating his earlier written submissions and having admitted the default, he requested for a lenient view in the matter. He also gave assurance with respect to compliance of the law and ISAs in future.

5. Before proceeding further, it is necessary to advert to the following relevant provisions of the Ordinance, the Rules and ISAs.

Para 16 of IAS 1 provides that *an entity whose financial statements comply with IFRSs shall make an explicit and unreserved statement of such compliance in the notes. An entity shall not describe financial statements as complying with IFRSs unless they comply with all the requirements of IFRSs.*

In terms of Para 10 of IAS 1-*Presentation of Financial Statements* and Para 1.1 of AFRS for MSEs a complete set of financial statements includes a statement of changes in equity for the period.

Para 27 of IAS 1 provides that *an entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting.*

ISA 200 *"Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with International Standards on Auditing ("ISA 200")* provides 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……….continued*
>
> ***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………..continued*

ISA 705 *"Modifications to the Opinion in the Independent Auditor's Report"* ("*ISA 705*") provides as under:

> *A2. ISA 700 requires the auditor, in order to form an opinion on the financial statements, to conclude as to whether reasonable assurance has been obtained about whether the financial statements as a whole*

are free from material misstatement. This conclusion takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements in accordance with ISA 450.5

***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)

Paras 7, 8, 9 and 10 of the ISA 705 prescribe the criteria for determining the type of modification to the auditor's opinion.

Section 255 of the Ordinance prescribes powers and duties of the auditors and sub-section (3) specifically prescribes the mandatory contents of the audit report.

Section 260 of the Ordinance states as under:

"(1) If any auditor's report is made, or any document of the company is signed or authenticated otherwise than in conformity with the requirements of section 157, section 255 or section 257 or is otherwise untrue or fails to bring out material facts about the affairs of the company or matters to which it purports to relate, the auditor concerned and the person, if any, other than the auditor who signs the report or signs or authenticates the document, and in the case of a firm all partners of the firm, shall, if the default is wilful, be punishable with fine which may extend to one hundred thousand rupees.

(2) If the auditor's report to which sub-section (1) applies is made with the intent to profit such auditor or any other person or to put another person to a disadvantage or loss or for a material consideration, the auditor shall, in addition to the penalty provided by that sub-section, be punishable with imprisonment for a term which may extend to one year and with fine which may extend to one hundred thousand rupees."

6. I have analyzed the facts of the case, the relevant provisions of the Ordinance, requirements of ISAs and the arguments put forth by the respondent. My observations in this regard are as under:

a) The Commission through its notification number SRO 23(I)/2012 dated January 16, 2012 has notified the AFRS for non-listed companies that are MSEs or SSEs. The notification defines the MSEs and SSEs and in terms of Para 3 of the notification, non-listed companies that are not MSEs or SSEs shall follow the International Financial Reporting Standards ("IFRS") notified by the Commission for the listed companies or any such standards as notified by this Commission from time to time. Since the Company does not fall within the definition of MSEs or SSEs, therefore, in terms of the aforesaid notification, the Company is required to follow the IFRS. It is important to note that unless any standards or financial reporting framework are notified by the Commission, it has no statutory recognition and cannot be applied by the companies in preparation of their financial statements. Therefore, the respondent's statement that the Company has prepared the Accounts for the next year ended June 30, 2014 based on the "Guideline for Non-Government Organizations (NGO) / Non-Profit Organizations (NPOs)" issued by the Institute of Chartered Accounts of Pakistan does not confirm compliance with applicable financial reporting framework.

b) In line with the requirements of IAS 1 applicable to the Company, it was required to prepared its 'Income and Expenditure Account' on accrual basis. Therefore, there is no justification for preparation of 'Income and Expenditure Account' on cash basis by the Company. The respondent's failure to modify his report to highlight this non-compliance by the Company renders him liable for contravention with the requirements of the law and ISAs applicable on audit of Accounts.

c) The Company failed to follow the requirements of IAS 1 applicable to it with regard to 'The Statement of Compliance' disclosed in the Accounts. The statement was not in accordance with the requirement of Circulars 7/2007 *(applicable to companies other than MSEs and SSEs)* dated November 2, 2007 issued by the ICAP. The auditor failed to highlight this fact in his report to members.

d) The Company did not prepare and annex to the Accounts a Statement of Changes in Funds as per requirements of IAS 1. The respondent failed to bring out this fact in his report.

e) In respect of signing and stamping of the Accounts by the respondent, it is important to note that preparation of financial statements is responsibility of the management and it is auditor's responsibility to express an independent opinion on the financial statements. Therefore, the auditor should not sign and stamp the Accounts to avoid giving any impression that Accounts have been prepared or authenticated by him. This is amply clarified by the ICAP through its Circular No. 4 of 1999 dated June 17, 1999.

7. Before proceeding to decide the matter, I deem it necessary to make some observations on the role of auditor of a company. The duties and responsibilities of an auditor appointed by the shareholders under the law 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. They elect directors and entrust the affairs of the company to them in the hope that they will manage the company to shareholders' benefits. There is no such arrangement in place whereby the shareholders can have an independent view as to how the directors have managed the affairs of the company. The financial statements are the most important source of reliable information for the shareholders who make their investment decision based on such information. The financial statements not only show the financial position and performance of the company but also show the results of management's stewardship of resources entrusted to it. Therefore, correct reporting in the financial statements in line with applicable financial reporting framework is of utmost importance. The law, therefore, recognizing this situation, has provided for the appointment of auditors who shall be responsible to audit the books of account, documents and financial statements required by the law and make out a report on them at the end of each year. This being the only safeguard provided by law to the shareholders to ensure accountability of the management, put the auditors to a high level of accountability in case they fail to make out a report in accordance with the legal requirements. For these reasons, it is of utmost importance for the auditors to exercise due care and diligence in performing their duties and discharging their responsibilities and maintain a high level of trust and integrity at their end.

8. For the foregoing reasons, I am of the view that the respondent in his audit report to members on Company's Accounts for the year ended June 30, 2013 did not appropriately modify his opinion, despite the apparent non-compliances by the Company, as highlighted in the preceding paragraphs. Hence he failed to bring out material facts about the affairs of the Company in his report which was not in conformity with the requirements of section 255 of the Ordinance.

As such he is liable to penalty under section 260 of the Ordinance. However, taking into account the admittance of default by the respondent and his assurance for future compliance, instead of imposing maximum penalty, I hereby impose a fine of Rs5,000/- (Rupees five thousand only) on the respondent under sub- section (1) of section 260 of the Ordinance.

The respondent is directed to deposit the aforesaid fine in the designated bank account maintained in the name of Securities and Exchange Commission of Pakistan with MCB Bank Limited within thirty days from the receipt of this Order. The respondent must furnish receipted vouchers for information and record, failing which proceedings under the Land Revenue Act, 1967 will be initiated that may result in the attachment and sale of movable and immovable property.

Tahir Mahmood
Commissioner (Company Law Division)

Announced:
September 9, 2015
Islamabad