



Corporate Supervision Department
Company Law Division

Before Mr. Tahir Mahmood – Commissioner (Company Law Division)

In the matter of

**Mr. Asad Feroze Partner Junaidy Shoaib Asad & Co. Chartered Accountants
Auditor of Flying Craft Paper Mills (Private) Limited**

Number and date of notice: EMD/242/P/12/2009/1419 dated April 11, 2014
Date of hearing: September 9, 2015
Present: Mr. Asad Feroze - Partner
Junaidy Shoaib Asad & Co. Chartered Accountants

ORDER

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

This order shall dispose of the proceeding initiated against Mr. Asad Feroze partner of Junaidy Shoaib Asad & Co. Chartered Accountants ("respondent") through show cause notice (the "SCN") dated April 11, 2014 under the provisions of Section 255 read with Section 260 and 476 of the Companies Ordinance 1984 (the "Ordinance").

2. The brief facts of the case are that the respondent audited the annual audited accounts of Flying Craft Paper Mills (Private) Limited ("Company") for the financial year 2008, 2009, 2010, 2011 and 2012 and issued unqualified audit reports except 2009 where the report for the year was qualified on the issue of depreciation rate. The review of aforesaid financial statements revealed the following inadequacies.

- i. Sales of the Company have reduced from Rs. 290 million (2009) to Rs. 43 million (2012), the Company has been in net loss since the year 2010. The Company is charging depreciation @1% since the year 2009. The accumulated loss of the Company is Rs. 103 million and net equity is only Rs. 26 million. Had the Company have amortized the deferred cost the net equity of the Company as on June 30, 2012 would have been negative Rs. 36 million without adjusting the amounts of depreciation not charged. The Company has not discussed the appropriateness of using Going Concern assumption in preparation of Accounts in Notes to the Accounts.
- ii. The Company has failed to comply with the provisions of Section 5 of Accounting and Financial Reporting Standard ("AFRS") for medium size entity ("MSEs") by not charging deferred cost to profit and loss account of Rs. 58.37 million.
- iii. The Company has failed to comply with the provisions of Section 3.33 of AFRS for MSEs and ICAP's Circular No 10/2002 dated November 11, 2002 relating to charging depreciation on its assets;



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- iv. The Company has failed to comply with the disclosure requirements of Section 3.40 of AFRS for MSEs relating to revaluation of assets;
 - v. The Company has failed to comply with the provisions of Section 3.19 of AFRS for MSEs by selective revaluing the assets of the Company and not revaluation the entire class of the assets;
 - vi. The Company has not complied with the provisions of Section 11 of AFRS for MSEs by recognizing deferred tax assets despite the Company being incurring losses.
3. The respondent while making out their report to the members neither stated the aforementioned facts nor did he express a qualified opinion/adverse opinion as appropriate with specific reference to the fact of uncertainty with regard to going concern as required by the ISA and the existence of non-compliances with the provisions of the AFRS. The audit reports on the aforesaid accounts were prima facie, not in accordance with the requirements of Section 255 of the Ordinance and ISA and the auditor failed to bring out material facts about the affairs of the Company. Therefore, SCN was issued to the auditor for *prima facie*, contravention of Section 260 of the Ordinance.
4. The reply to SCN was submitted by the auditor vide letter dated May 13, 2014. The seriatim reply is summarized below.
- i. The management representations were obtained in this regard and future plans were reviewed. Bank payment records were analyzed and subsequent events were studied and our conclusion was that Company would continue as a going concern.
 - ii. The amortization was deferred on account of financial position of the company. It is correct that as per MSE standards deferred cost is to be charged to P&L but it could not be charged as it was a transaction which occurred before application of MSE standards. There are no transitional provisions mentioned in MSE standards regarding treatment of transactions which occurred before application of MSE standards.
 - iii. The assets disposed off during the year were not depreciated as these were set aside for disposal at the start of the year and were not used during the year.
 - iv. It is regretted that the comprehensive disclosure in notes to the accounts regarding revaluation of assets has not been provided. However, it has no material effect on the truthfulness of the accounts.
 - v. Management got revalued its assets located at Charsadda for the purposes of obtaining of loans from banks and according to the requirement of lender of the money the assets located at Sheikhpura were not revalued.



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vi. Deferred tax asset was recognized in the accounts on the assumptions that in future the taxable profits would be available to adjust the unused tax losses.

5. In order to provide opportunity of personal hearing; the case was fixed before the undersigned on September 9, 2015. Mr. Asad Feroze appeared and admitted the default and submitted that error occurred due to oversight at the start of his career and now the firm has taken steps to increase the compliance level and assured that in future these errors will not happen. It was also stated that retrospectively due to the efforts and improvement the firm has successfully attained the satisfactory QCR rating. The Company is closely held by family members and no public money involved.

6. Before proceeding further, it is necessary to advert to the following relevant provisions of Section 260 of the Ordinance, which states as under:

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.

7. I have analyzed the facts of the case, relevant provisions of the Ordinance and ISA, arguments put forth by the auditor in writing and during the hearing and observed as follows;

- i. There is a doubt on the going concern ability of the Company as it has scaled down its operations since 2009 and operating in losses, further the scale of loss incurred by the Company has been curtailed by not recording depreciation at actual rate and reluctant of charging off the depreciation cost. Consistent losses over a long period of time results in erosion of shareholders equity thereby diminishing the Company's ability to operate. The respondent has merely relied on the management representation and has not analyzed their statement in light of ground realities faced by the Company. If that would have been the case the respondent in light of the guidance provided by the ISA would have appropriately modified their report highlighting the uncertainty faced by the Company in continuing as a going concern.
- ii. AFRS for MSE do not define the transitional provision for the application of AFRS. These are applicable since August 2007. In absence of any transitional provisions, it is construed that the provisions of AFRS are applicable from that year. Therefore, Rs. 58.37 should have been charged to P&L accounts in the financial year 2008. Also, since 2008 the Company has expressly stated in the "Statement of Compliance" that these accounts are prepared in accordance with the AFRS for MSE. Moreover, Section-12.1 of AFRS for MSE requires that



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if there is no specific requirement in AFRS, then management shall look for guidance into IAS/IFRS, SIC/IFRIC etc. Para-69 of IAS-38 has similar accounting requirement as that of AFRS w.r.t. deferred cost.

- iii. The Company has failed to comply with the provisions of Section 3.33 of AFRS for MSEs and ICAP's Circular No 10/2002 dated November 11, 2002 which states that depreciation of an asset ceases the date when the asset is derecognized. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.
- iv. The Company has failed to comply with the disclosure requirements of Section 3.40 of AFRS for MSEs relating to revaluation of assets which the auditor failed to highlight in his report.
- v. The Company has failed to comply with the provisions of Section 3.19 of AFRS for MSEs by selective revaluing the assets of the Company and not revaluation the entire class of the assets which the auditor failed to highlight in his report.
- vi. The Company has been in operating loss since 2009 and there are material uncertainties exist which cast significant doubt about the entity ability to continue as a going concern therefore, it is not probable that future taxable profits will be available to use unused tax losses.

8. For the foregoing reasons, I am of opinion that the auditor failed to bring about material facts about the affairs of the Company and accordingly auditor's report has not been made in conformity with ISA 705 and Section 255 & 260 of the Ordinance. However, I have also noted that the respondent has admitted oversight on his part. The self-realization and corrective measures taken for avoidance of future errors is also reassuring. The enforcement and regulatory function the Commission is aimed at building a compliant corporate culture, an auditor has a key role in ensuring that seed of this culture grows and is well nurtured. The self-realization by respondent in the case at hand is heartening; therefore, I take a lenient view and hereby warn the respondent to ensure meticulous compliance of law in future.



Tahir Mahmood
Commissioner
Company Law Division

Announced:
September 18, 2015
Islamabad