[Islamabad]

Before Mr. Ashfaq Ahmed Khan, Director Enforcement (Company Law Division)

In the matter of

M/s Tariq Ayub Anwar & Co. Chartered Accountants

Under Sub-section (1) of Section 260 read with Section 255 and 476 of the Companies Ordinance 1984

Number and date of notice	No. EMD/233/571/2002 dated March 22, 2006
Date of hearing	July 07, 2006
Present	• Mr. Tariq Ayub Qureshi, FCA, Partner, M/s Tariq Ayub Anwar & Co. Chartered Accountants. • Mr. Faisal Latif, ACA, Partner, M/s Tariq Ayub Anwar & Co. Chartered Accountants.
Date of Order	August 10, 2006

ORDER

This order shall dispose of the proceedings initiated against M/s Tariq Ayub Anwar & Co., Chartered Accountants through show cause notice dated March 22, 2006 under Sub-section (1) of Section 260 read with Section 255 and 476 of the Companies Ordinance, 1984 (the "Ordinance") for making report to the members of M/s Wah Nobel Chemicals 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.

2. Tariq Ayub Anwar & Co., Chartered Accountants is a partnership firm and the partners Mr. Mohammad Anwar Khan, FCA; Mr. Tariq Ayub Qureshi, FCA; Mr. Ishfaq Ahmed, FCA; Faisal Latif, ACA 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 Tariq Ayub Anwar & Co., Chartered Accountants (hereinafter referred to as the "Auditors") were appointed as auditors of the Company for the financial years ended on June 30, 2003 and June 30, 2004 (hereinafter referred as "financial year 2003" and "financial year 2004") in its Annual General Meetings held on November 15, 2003 and October 29, 2004 to hold office until the conclusion of next Annual General Meetings. The Auditors have audited the accounts and books of accounts of the Company and have made audit report on the financial statement of the Company for the said two financial years. The Enforcement Department conducted an examination of the annual reports and financial statements of the Company for the year ended June 30, 2003 and June 30, 2004 to determine, among other things, whether Auditors' reports pertaining to the aforesaid financial years had been made in conformity with the requirements of Section 255 of the Ordinance, are otherwise true, contain no such statement which is materially false and there is no omission of material facts about the affairs of the Company.

4. Review of Auditors' report for the aforementioned financial years revealed that the Auditors' issued reports *without any modification* for both periods as is evident from the following opinion paragraphs of the said reports reproduced below for ready reference:

i) the balance sheet and profit and loss account together with the notes thereon have been drawn up in conformity with the Companies Ordinance, 1984 and are in agreement with the books of account and are further <u>in accordance with accounting policies consistently applied.</u>

ii) In our opinion and to the best of our information and according to the explanations given to us, the balance sheet, trading, profit and loss account,

> *cash flow statement and statement of changes in equity together with notes forming part thereof, conform with approved accounting standards as applicable in Pakistan, and give the information required by the Companies Ordinance, 1984, in the manner so required and respectively give a true and fair view of the state of company's affairs as at --------(respective years) and of the profit/loss, its cash flow and changes in equity for the year then ended.*

5. The examination of the audited accounts of the Company for the year ended June 30, 2004 and then June 30, 2003, however, revealed that certain requirements of International Accounting Standards and Companies Ordinance, 1984 were not followed by the Company and that accounting policy for recording and disclosure of 'revenue' was not consistently applied as under:-

i. During the year ended June 30, 2004; Company disclosed a significant amount of Rs. 84.828 million as "recoveries/adjustments" as a set off against cost of goods manufactured. This was, *prima facie*, a material amount as it was 28% of the gross sales and 155% of gross profit of the Company. As the head "recoveries/adjustments" first time appeared in the accounts and that too with a material value and without any explanation; the matter was taken up with the Company and explanation was called. After lengthy correspondence with the Company it was learnt that "recoveries/adjustments" of Rs. 84.828 million was actually "revenue from other services". Due to obvious misstatements of material facts by the Company in financial statements of year 2004, the Enforcement Department examined the financial statements of previous/subsequent years with special focus on "revenue from other services". It was then observed that prior to financial year 2003, 'revenue from other services' was not a significant part of total revenue of the Company and was disclosed appropriately as shown in the following table. However, during financial year 2003 revenue from other services became significant as it stood at Rs. 37.78 million as compared to Rs. 3.92 million only during the previous year (16% of gross revenue from sale of manufactured products). During the year, 2003, Company altogether avoided disclosure of this sum and apparently adjusted this amount against "raw material purchased" figure. During

2004, as discussed earlier, amount against this head was disclosed as 'recoveries/ adjustments' and was set off against cost of goods manufactured. However, in the financial statements of subsequent financial year ending on June 30, 2005, audited by another auditor, M/s Ford Rhodes Sidat Hyder & Company, Chartered Accountants, again this amount was shown as 'revenue from service charges' (Amount of Rs. 84.828 million shown as revenue in previous year figures). As such disclosures/ non-disclosure during the years 2004 and 2003 is, *prima facie*, against the provisions of International Accounting Standards (IAS) which has resulted in misstatement of cost of goods manufactured during these years. The year to year disclosure pattern of 'revenue from other services' is given in following table:

Rs. In million

	2000	***2001***	***2002***	***2003***	***2004***	***2005***
Auditors	TAA	TAA	TAA	TAA	TAA	FRSH
Tariq Ayub, Anwar & Co.(TAA) Ford Rhodes Sidat Hyder & Co. (FRSH)						
Sales						
Gross revenue from sale of manufacturing products	172.23	230.59	248.18	236.02	304.17	533.22
Less: Sales tax	23.25	30.82	35.48	32.75	44.56	69.60
	148.97	199.78	212.71	203.27	259.61	463.61
Add: revenue from other services	12.77	9.57	3.92			38.85
	161.75	209.35	216.62	203.27	259.61	502.46
Cost of Goods Manufactured					xx.xx	
Recoveries/Adjustments					**(84.83)**	
Comments				Amount of Rs. **37.78** million was nowhere disclosed.	Disclosed under a different head & set off against CGM	

ii. During financial year 2004, Company's revenue from other services was Rs. 84.828 million which was 22% of total turnover of the Company (Gross sales plus

revenue from other services). Therefore, the financial results on account of other services should have been disclosed separately as per requirements of 4th Schedule to the Ordinance.

6. In view of the above, the Enforcement Department got concerned with regard to the quality of audit of the Company conducted by the Auditors and the audit reports given by them on the Accounts of the Company for the year ended June 30, 2004 and June 30, 2003. Consequently, a show cause notice was issued to the the Auditors on March 22, 2006 pointing out their responsibilities under the Ordinance, International Accounting and Auditing Standards and non-compliances observed in the Accounts. A period of 14 days was given to respond to the aforesaid notice. Subsequently, a brief reply of the Auditors was received on April 26, 2006 in which following submissions were made by the Auditors:

i The charges of misleading/non-disclosure of material amounts are denied. Please let us know how the taxable profits and distributable earnings of the Company during the relevant years have been affected by the allegedly erroneous disclosures highlighted in the show cause notice.

ii Amount of Rs. 84.828 million were reimbursement of expenses incurred by the Company to affect the sales thus this cannot be construed as a separate line of business. Further these expenses were recouped through an agreement between the Company and its associate Wah Nobel Detonators (Pvt) Limited

7. In order to provide an opportunity of personal hearing, the case was fixed for July 07, 2006. On said date Mr. Tariq Ayub Qureshi, FCA and Mr. Faisal Latif, ACA; partners of Tariq Ayub Anwar & Co. appeared before me at the time of hearing and argued the case. The submissions earlier made in the aforementioned letter were repeated. Some other points raised at the time of hearing are summarized as under:

i Preparation of accounts is responsibility of the management and auditor only check them on sample basis and on the basis of their audit, auditors were satisfied that disclosures were appropriate as overall there was no effect on financial statements.

ii The amount of Rs. 37.78 million (mentioned in Paragraph 6 above) was not disclosed in the financial statements of 2003 as it was an immaterial amount. The adjustment of the amount of Rs. 84.828 million against cost of goods manufactured was also acceptable because IAS 1 allows immaterial items to be adjusted.

iii Mr. Tariq Ayub Qureshi was engagement partner for year 2003 and Mr. Mohammad Anwar Khan was engagement partner for year 2004.

8. After careful consideration of the contentions of the Auditors, I am of the view that the arguments put forward are not tenable as discussed below:

Financial results were not affected by alleged erroneous disclosures:

The auditor's submission that the alleged erroneous disclosures did not affect overall results and that the financial statements present a true and fair view of the state of company's affairs is not tenable in light of following provisions of IAS and Auditing Standards (AS).

Para 15 of IAS 1 (Presentation of Financial Statements) states that

"In virtually all circumstances, a fair presentation is achieved by compliance in all material respect with applicable International Accounting Standards. A fair presentation requires:

(a) selecting and applying accounting policies in accordance with paragraph 20.

(b) presenting information, including accounting policies, in a manner which provides relevant, reliable, comparable, and understandable information….."

Para 2 of AS 200 states that

"The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements, are prepared, in all material respect, in accordance with an identified financial reporting framework….."

The financial statements for the year 2004 and 2003 of Wah Nobel Chemicals Ltd. were not in compliance of the following provisions of IAS1:

"*Each material item should be presented separately in the financial statements. Immaterial amounts should be aggregated with amounts of similar nature or function and need not be presented separately*". **(Para 29)**

"Items of income and expense should be offset when, and only when, an international accounting standard requires or permits it; or gains losses and related expenses arising from the same or similar transactions and events are not material". **(Para 34)**

The Company has violated the above referred provisions of IAS 1 in respect of material amounts. In 2003 Rs. 37.78 million was not disclosed anywhere and apparently adjusted against raw material purchased, thereby showing a significantly lower raw material consumption. In 2004 the amount of Rs. 84.828 million was disclosed as recoveries/adjustments and was offset against cost of goods manufactured. This presentation of 'revenue from other services' (as subsequently learnt from correspondence with Company and from financial statements of 2005 audited by a separate auditor) rendered that particular and material information in financial statements as incomparable, unreliable and un-understandable. The Auditors were aware of this non-compliance, as was admitted during the course of hearing, but choose to overlook the non-compliance as they in their opinion the amounts were not material and non-disclosure and offsetting of these amounts were justified. They also ignored the violation of the Company on the unjust ground that this treatment did not affect the overall profitability.

Materiality:

The Auditors' contention that the amount of Rs. 37.78 million in 2003 and Rs. 84.828 million in 2004 were not material and that they agreed with the accounting treatment due to immateriality of figures, is quite unreasonable. In 2003 the amount of Rs. 37.78 million, which Company did not disclose in the year's financial statements, represented 16% of gross sales, 67% of gross profit, 12% of total balance sheet footing for the year. Similarly Rs. 84.828 million, which, in the financial statements of 2004 was set off against cost of goods manufactured, was equivalent to 28% of gross sales, 156% of gross profit and 21.7% of total balance sheet footing for the year. These were very material amounts by any given standards.

Revenue or Recovery of expenditure:

Auditors have submitted in writing and at the time of hearing that the amounts of Rs. 37.78 million and Rs. 84.828 million were in the nature of recovery of expenses incurred to effect the sales and not in the nature of revenue. Therefore the disclosure in 2003 and 2004 was different from previous years (please refer to table in Para 6). Auditor provided copy of agreement between the Company and its associate, to support this submission. The said agreement has been found to be entered on July 01, 2004 and does provide any evidence that the amounts in question were reimbursement of expenses rather then revenue items. Auditors' submission that nature of the transactions was different in 2003 and 2004 then previous years is not tenable because:

- No evidence has been provided to substantiate the claim; and
- The financial statements for the year ended June 30, 2005, audited by M/s Ford Rhodes Sidat Hyder & Company, Chartered Accountants, disclosed the amount of Rs. 84.828 million of 2004 as 'revenue' in line with the disclosures made prior to 2003.

Separate line of business:

In the show cause notice of the Commission, it was mentioned that Company should have shown the results from 'services' separately in line with the requirements of Para 7 of Part III of 4th Schedule to the Ordinance which provides that:

"where an undertaking has more than one line of business, the working results of each such line of business should be separately disclosed provided the turnover of such line of business exceeds twenty percent of the total turnover of the Company".

During 2004 the revenue from services exceeded 20% of turnover from manufacturing.

The auditors submitted that according to their audit conclusion the amount was reimbursement of expenses and not revenues, and therefore can not be constituted as separate line of business. The argument that the amounts were not revenue in nature, has already been denied in the foregoing rebuttal point. The amounts were obviously of revenue nature if seen in line with disclosure made in financial statements for periods prior and subsequent to 2003 and 2004. Moreover, the contention that these were recovery of

expenses incurred to affect the sales, is also not tenable. These amounts have no correlation to sales, which would substantiate the claim of auditors. Percentage of 'revenue from other services or recoveries (as claimed by Auditor)' to gross sales is shown below which clearly indicates that there is no relation between gross sales and so called 'recoveries' to affect sales and there is no point to substantiate auditor's claim that the amount of Rs. 84.828 million is not a separate line of business 'revenue from other services' are a separate line of business.

	2000	***2001***	***2002***	***2003***	***2004***	***2005***
Gross revenue from sale of manufacturing products	172.23	230.59	248.18	236.02	304.17	533.22
Revenue from other services (recoveries)	12.77	9.57	3.92	37.78	84.83	38.85
Percentage %	***7.4***	***4.15***	***1.58***	***16***	***28***	***7.3***

Moreover, Company in its financial statements, except for the years 2003 and 2004, has been disclosing two types of revinues i.e.:

- Revenue from sale of manufactured goods
- Revenue from other services

In these statements, the apparent intention of the Company is to disclose that main revenue is generated from sale of manufactured goods and some revenues are also generated from some kind of services being provided by the Company.

10. 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 qualified 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.

11. The duties and responsibilities of an Auditor appointed by the shareholders under Section 255 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 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 they failed 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.

12. Now reverting to the present case, it is clear from the preceding paragraphs that the auditors had failed to perform their statutory obligations by giving misleading information to the members and, in this way, had failed to perform their professional duties with reasonable degree of care and skill. They gave a clean bill of health to the Company's accounts. Auditors' statement that whatever is the position of disclosures, the overall profitability is not affected itself speaks about the quality of audit. Obviously auditor did not care whether correct, accurate and reliable information was being transmitted to users of financial statements or not, as provided by IAS.

13. After careful consideration of the conduct of the auditors of the Company and the circumstances of this case, I am of the view that Mr. Tariq Ayub Qureshi and Mr. Mohammad Anwar Khan of Tariq Ayub Anwar & Co., Chartered Accountants, have signed the audit reports dated September 07, 2004 and October 22, 2003 otherwise than in conformity with the

requirements of Section 255 of the Ordinance and have made themselves liable for punitive action under Sub-section (1) of Section 260 of the Ordinance.

14. For the reasons stated above, I impose a fine of Rs.50,000 (Rupees fifty thousand) each on Mr. Tariq Ayub Qureshi, FCA and Mr. Mohammad Anwar Khan, FCA who were engagement partners for audit of financial statements for the years ended June 30, 2004 and June 30, 2003; under Sub-section (1) of Section 260 of the Ordinance for making reports 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, 2005.

15. Mr. Tariq Ayub Qureshi, FCA and Mr. Mohammad Anwar Khan, FCA are directed to deposit the fine of Rs 50,000 each 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 receipted bank voucher to the Securities and Exchange Commission of Pakistan.

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Ashfaq Ahmad Khan
Director (Enforcement)