



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
(Enforcement Department)
[Islamabad]

Before Tariq Bakhtawar, Director Enforcement

In the matter of M/s Hyder Bhimji & Co. Chartered Accountants
for non-compliance with section 260 of the Companies Ordinance 1984

Number and date of notice	EMD/233/416/2002-8179-82 dated June 04, 2004
Date of final hearing	December 28, 2004
Present	Mr. Waleed Khalid, Legal Advisor Mr. S.M. Tanvir FCA, Partner Mr. Syed Aftab Hameed FCA, Partner
Date of Order	February 09, 2005

ORDER

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 Hyder Bhimji & Co., Chartered Accountants (hereinafter referred to as the “Auditors”) for making report to the members of M/s Tristar Power 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. M/S Hyder Bhimji & Co. Chartered Accountants is a partnership firm and the partners are Mr. Hyder Bhimji, FCA, Mr. Muhammad Hanif Razzak, FCA, Mr. Shaikh Mohammad Tanvir, FCA and Syed Aftab Hameed, 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 Hyder Bhimji & 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 April 18, 2003.

4. The Enforcement Department 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:

5.1. Going Concern Assumption

The Company is a captive power project and is engaged in generating, distributing and supplying electricity to its associated undertaking M/S Tri Star Polyester Limited (TPL). The Company's ability to continue as a going concern was dependent on its sole Client's ability to continue as a going concern and the TPL was in financial and operational distress. The Company had suspended its operations since 2001, its accumulated losses stood at Rs. 32.296 million and it had a negative cash flow during the year. Directors had not given any prospect for the revival of the Company in their report to the members. These circumstances gave rise to significant doubt regarding the Company's ability to continue as a going concern. The Company had not explained the appropriateness of using Going Concern assumption in preparation of the Accounts and the Auditors failed to modify the opinion regarding validity of going concern assumption as per Auditing Standards, as applicable in Pakistan;

5.2. Impairment of Investment

The Company had not made provisions for impairment against investments amounting to Rupees 36.700 million in its associated company M/S Tristar Energy Limited considering the fact that it had not started its commercial operations and the Commission had filed a petition for winding up of M/S Tristar Energy Limited on August 08, 2000. The Auditors failed to modify their opinion in audit report on the accounts of the Company for the year ended June 30, 2002 in this regard.

5.3. Verification of Assets

Income Tax authorities seized the record of the Company in 1996 and since then Company did not maintain Fixed Assets Register. Note 4.2 of the financial statement for the year ending June 30, 2002 disclosed that Auditors had not been able to physically verify fixed assets of the Company valuing Rs.71.745 millions and note 5.4 disclosed that NIT Units amounting to Rs.34.595 millions were not in the custody of the Company. The auditors have just given matter of emphasis to the relevant notes and have stated in their report that proper books had been kept by the Company.

5.4. Disclosure Deficiencies

Company had not followed the disclosure requirements of the following International Accounting Standards and Fourth Schedule to the Ordinance:

- a. Disclosure of Staff Retirement benefits according to Para 120 of IAS –19 (Employee Benefits)
- b. Disclosure for shares held by associated undertaking in the share capital of the Company as required by Para 74 of IAS 1(Presentation of Financial Statements).
- c. Building shown in fixed assets had not been distinguished into building on leasehold or freehold land as required by Para 2 of Part II of 4th Schedule of Companies Ordinance, 1984.
- d. Disclosure regarding date, as to when the financial statements were authorized for issue, and who gave that authorization, had not been given as required by IAS 10 (Events after balance sheet date)
- e. Plant capacity for the year had not been given as per the clause (vii) of Para 2 of Part 1 of the Fourth Schedule to the Ordinance.
- f. Name and amount due from each associated undertaking was not disclosed (Note 7 to the accounts) as per Sub-clause (b) of clause C of para 6 of Part II of Fourth Schedule to the Ordinance.
- g. Purpose of reserve had not been given as per Para 74 (b) of IAS 1(Presentation of Financial Statements).
- h. Disclosure of Credit risk as per Para 66 of IAS 32 (Financial instruments: Disclosure and Presentation).
- i. Accounting policy relating to provisions was not given as required by Para 97 of IAS 1 (Presentation of Financial Statements); Moreover, the accounting policy on stores and spares was not correct as per IAS 2 (Inventories)

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 report given by them on the accounts of the Company for the year ended June 30, 2002. It was observed that the Auditors failed to modify the opinion regarding validity of going concern assumption and also failed to address other issues as per Auditing Standards applicable in Pakistan;

7. Consequently, a show cause notice was issued to all the partners of M/s Hyder Bhimji & Co., on June 04, 2004 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 Auditors sought several extensions and were finally advised to submit reply by August 03, 2004. The reply was finally received on August 02, 2004. In order to provide an opportunity of personal hearing, the case was several times adjourned on request of the Auditors. Finally, hearing was fixed for December 28, 2004 on which date Mr. Waleed Khalid, Legal Advisor along with Mr. S.M.Tanvir FCA, and Mr. Syed Aftab Hameed FCA, Partner appeared before me at the time of hearing and argued the case. The submission made by them to the aforesaid SCN are summarized as under:

7.1. Going Concern Assumption

The auditors have explained the responsibility of management as well as of auditors with respect to the financial statements under consideration. They have quoted IAS-1 and ISA-23 in support of their argument and argued that the Company's main business was the operation of the captive power project dedicated to its associated company TPL and it continued the transmission of electricity till the year ended June 30, 2000 which was discontinued with the advent of financial year 2001. The plant of the Company is in order and is capable of generating electricity and once the use of production facilities of the associated company are re-commenced, the Company will start generating and supplying electricity to it. Losses are in fact Non-Funded losses and are attributable to unabsorbed depreciation, diminution in value of investment and accruals. Management made positive assessment of going concern in the director's report. No detailed analysis was required by the management as the Company had a history of profitable operations and ready access to financial resources. The Auditors made investigations and were satisfied of management assessment on grounds that:

- there were few liabilities,
- sponsors of the Company were willing to inject new funds,
- carrying value of assets and liabilities of Company approximated fair value, and
- Checklist according to ISA 8 was evaluated

The Auditors, therefore, did not find any reason to modify their report. The auditors were asked to provide audit evidence obtained by them to ensure the appropriateness of Management's use of going concern assumption with specific reference to the fact that TPL was sole customer of the Company. In response to this the Auditors in their reply dated January 18, 2005 stated that the Audit of the Company was started in March 2003 and the Audit Report was signed on April 18, 2003. At the time of the signing of the Report both the Company and M/s Tri-Star Polyester were in operation and there was no real/serious issue of the going concern assumption. Further evidences that were considered by them with regard to the going concern assumption are as follows:

- a. The recommended Going Concern Review Checklist was duly completed by the in-charge of the audit for forming an opinion in respect of the use of going concern assumption.
- b. The plant was properly kept and the Company was capable of restarting power generation upon re-commencement of operations of its associated concern and at time of signing the report M/s Tri-Star Polyester had recommenced the operations so did the Company.
- c. The project is an equity financed project without any financial leverage hence there was no imminent risk of defaults of any nature of any bank or lenders and neither was there a risk of foreclosure.
- d. The directors were committed to provide / arrange finances for the business of the Company from their own sources as and when needed.
- e. The loss incurred by the Company was substantially due to charge of depreciation on fixed assets and making a provision for diminution in the value of investments as at June 30, 2002, which are non funded/non cash items. Fair value of these investments in subsequent years rose to such an extent that it may cover the whole loss of the Company.
- f. There was no negative financial or other indication whatsoever.

- g. The foreseeable period as provided in the relevant Auditing guidelines for determining whether the company is going concern is one year and at the time of issuing the report, nine months had already elapsed out of one year and the Company was in operation during that period.

7.2. Impairment of Investment

Value of investment in M/s Tri star Energy Limited (the “Investee”) was not impaired, which is an unquoted company, therefore, value of investment was taken from its financial statements in absence of any other source. Moreover, financial statements of Investee company made available to auditors did not disclose any facts about going concern or winding up proceedings initiated by SECP.

7.3. Verification of Assets

In 1997, the first year after impounding of all records by Income Tax authorities, the Auditors thought that issuing negative remarks in their report will be unjustified as the physical existence of these documents was verified during the preceding year. With passage of time, auditor gave emphasis to the matter in their report because of uncertainty of the matter. Their report is in line with the requirements of AS 13 Para 33.

7.4. Disclosure Deficiencies

Response towards non disclosure of the International Accounting Standards and Fourth Schedule to the Ordinance is as under:

- a. There was no employee and previous liability was immaterial. Therefore, in view of the management cost associated with actuarial valuation was not justified.
- b. Para 74 of IAS-1 required disclosing investment in “Associates” and definition of Associates in IAS is different from definition of “Associated Undertakings” in the Ordinance.
- c. Building was provided by TPL (the customer) so no such disclosure was warranted.
- d. Date of authorization had been disclosed in directors’ report.
- e. Purpose of the Company is to supply electricity to TPL as per their requirements. In current situation the disclosure regarding Plant capacity was irrelevant.
- f. As Company had only one customer so receivables were from that undertaking.
- g. Purpose of General Reserve was to strengthen the state of affairs of Company.

- h. There was no particular credit risk associated with the organization, which needed to be disclosed.
- i. “Provision” is an accounting principal and the same had been defined in IAS 37. Policy regarding stores was as per IAS. Collecting market information is a futile exercise.

8. I have taken into consideration the submissions, made in writing as well as those at the time of hearing of this case and am of the view that most of the grounds taken by the Auditor are not convincing due to the following reasons:

8.1. Going Concern Assumption

The Company is captive power project and is engaged in generating, distributing and supplying electricity to its associated undertaking TPL. The Company’s ability to continue as a going concern is dependent on its sole Client’s ability to continue as a going concern.

The argument of the Auditors that the Accounts of the Company should have been prepared on going concern assumption is not based on true facts as discussed in ensuing paras:

- a. The Company has suspended its operations since 2001 and the Directors in the Directors’ Report while explaining the business have stated that

Quote

“Your Company supply electricity to the associated company viz. Tri-star Polyester Ltd., which is not running as a result the sale of your company are effected”

Unquote

The above statement is clear indicative of the fact that the operations of the Company were dependent upon the associated company. In the subsequent years no revival was seen in the Company due to the fact that its sole customer i.e. TPL did not revived its operations.

- b. The accumulated losses of the Company as at June 30, 2002 stood at Rs. 32.296 million and these were due to no power generation activity. The sales of the Company were affected much earlier and the accounts of the year 2001 show nil sales. The auditors arguments that the losses are attributable to unabsorbed depreciations, provision for diminution in the value of investment and accruals do not carry weight. These cost parameters are very much part of the operations and the sales was required at a level, where profit is generated after providing for all the operational expenses. In my opinion the accumulated losses were due to the fact that the Company could not sale its product, due to non-existence of demand from the sole customer.
- c. The Company had negative cash flows for the year. The Auditors' argument that negative cash flow is of a small amount does not carry any weight as the negative cash flow itself should have raised their concern. Having negative cash flow indicates that the Company is under financial stress and that is due to cash inflow dependence on the sole customer.
- d. The directors of the Company did not give any prospect of revival of the Company in their report to the members and non discussion for such important matters required auditors' special attention. The Auditors in their reply have admitted that the revival of the Company is solely dependent upon the operations of the TPL. However, the director's report was silent on the issue.

The aforesaid discussion confirms that the Company was dependent on the sole customer and conditions existed, which required the Auditors to perform audit work related to the going concern assumption. The Auditors were also fully aware of the affairs of the Company's sole customer i.e. TPL, as they were also auditors of the TPL since incorporation till they were removed by TPL in December 2003.

The TPL was facing going concern issues itself as indicated below:

- Financial statements for the year ended on June 30, 2000 disclosed that against paid up capital of Rs.214.657 million, the accumulated loss was Rs. 206.843 millions and this loss would have further increased to the tune of 245.87 millions if depreciation would have been charged at normal rate of 10% as per practice in the previous years (as stated by auditors in their audit report).

- TPL failed to hold AGMs for the year 2001 and 2002 attracting provision of the Section 305(b) of the Ordinance. These defaults were committed before the date of signing of the audit report of the Company for the year ended June 30, 2002 i.e. April 18, 2003.
- TPL failed to circulate annual accounts and balance-sheet to shareholders for the aforesaid years.
- Current liabilities of TPL increased over current assets by an amount of 187.820 millions and for the next years M/S Tri Star Polyester Limited was not in operations.

It is established that the Company operations were dependent on the sole customer and the going concern issues with the TPL vis-à-vis confirms that the management's going concern assumption in case of the Company was not valid.

Regarding, the Auditor's argument that they have evaluated the going concern assumption in light of the Para 8 of ISA 23. The Para 8 of ISA 23 gives examples which may cast significant doubt about the going concern and the current case is one of such model, the loss of sole client indeed falls under the "loss of major market". This should have raised concerns of the Auditors and accordingly they should have modified the report. The Auditors, in their submissions, have affirmed their responsibilities and stated that:

Quote

"Paragraph 30 of the ISA states that based on the audit evidence obtained, the auditors should determine if in the auditors judgment a material uncertainty exists in relation to events or condition that alone or in aggregate, may cast significant doubt on the entity's ability to continue as going concern"

Unquote

On the foregoing, I am convinced that the going concern assumption was not appropriately used by the management and the Auditors in spite of having sufficient audit evidence have failed to modify their report accordingly.

8.2. Impairment of Investment

Statement of the Auditors that investment is not impaired meant that they are supporting the view of management. Para 38 of AS 8 states that when long term investments are material to financial statements, auditor should obtain sufficient appropriate audit evidence regarding their valuation and disclosure. The long term investments of Company are 35% of its total assets. The AS also provides that such procedures ordinarily include taking written representations from management regarding status of investment. However no such representation was obtained from management. Hence an unqualified opinion was not justified.

8.3. Verification of Assets

For four years, the Auditors thought about issuing negative remarks is unjustified. The Auditors emphasized the matter in 2001 for the first time, although the assets continued to remain unverified for all these years. In this case there is no uncertainty that required a matter of emphasis para. The Company did not maintain proper books and its assets were unverified for six years. Hence, auditors were required to qualify their report on these issues, which they failed to do so.

8.4. Disclosure Deficiencies

The disclosures deficiencies are as follows;

- a. The Auditors' argument that the number of employees have not been disclosed as there were no employees at all, cannot be accepted, as the absence of employees does not warrant that the disclosure of the same should not be given in the Accounts. In such a situation, the best is to disclose that there are no employees working in the Company.
- b. The Auditors' argument that, definition of associated undertaking in the Ordinance and associates in IAS is different, is not relevant in this matter. The Company should have disclosed name of the associated undertaking as per requirement of IAS.
- c. The Auditor's argument that building is neither owned nor leased is not satisfactory. If building is not owned by the Company nor leased then there is no justification for disclosing it as an asset.

- d. The Auditors' argument that the date of authorization was disclosed in director's report is not correct. The director's report shows the date of report. Date of authorization of the financial statements and approving body had not been disclosed.
- e. Fourth Schedule required the disclosure in respect of plant capacity despite the situation of the Company.
- f. Name of the associated undertaking should have been disclosed as required by the 4th schedule of the Ordinance.
- g. The purpose of the general reserves has been provided and the same is found to be satisfactory.
- h. The Auditors' argument, that there was no credit risk associated with the company hence no disclosure was required, is not satisfactory. In such a situation, the best is to disclose that there is no credit risk associated with the Company.
- i. The Auditor's argument is not satisfactory as Policy for provisions was not given in the financial statements. Moreover Policy for stores and spares was not as per IAS 2. the practice of writing inventories down to NRV is consistent with the view that assets should not be carried in excess of amounts expected to be realized from their sale or use (Para 25) Stores and spares have been shown at same level for three years. There is fair chance that there may be damage, obsolescence or that their selling price had been declined.

9. 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.

10. 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 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.

11. It is clear from the above discussion that the Auditors had failed to perform their 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 their Audit Report to the members. In the circumstances, it was clear that the Auditor had failed to perform their professional duties with reasonable degree of care and skill. They knowingly and recklessly ignored their observations and gave a clean bill of health to the Company's accounts.

12. For the reasons stated above, I impose a fine of Rs. 10,000 (Rupees ten thousand) each under Sub-section (1) of Section 260 of the Ordinance on all partners of M/s Hyder Bhimji & Co., namely, Mr. Hyder Bhimji, FCA, Mr. Muhammad Hanif Razzak, FCA, Mr. Shaikh Mohammad Tanvir, FCA and Syed Aftab Hameed, 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.

13. The above referred partners of Hyder Bhimji & Co. are 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.

14. 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.

Tariq Bakhtawar
Director Enforcement

Announced:
February 09, 2005
ISLAMABAD