



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Company Law Division

Enforcement Department

[Islamabad]

Before Ashfaq Ahmed Khan, Director Enforcement

In the matter of

M/s Saeed Methani Mushtaq & Co., Chartered Accountants

(Under Rule 35 of the Companies (General Provisions And Forms) Rules, 1985 And Sub- Section (1) of Section 260 Read With Section 255 And 476 of the Companies Ordinance, 1984)

Number and Date of Show Cause Notice: No. EMD/233/389/2002
January 6, 2005

Date of Hearing: February 10, 2005

Present: Mr. Saqib Rehman Qureshi, FCA

Order

This order shall dispose of the show cause proceedings initiated against M/s Saeed Methani Mushtaq & Co., Chartered Accountants (hereinafter called “the auditors”) under Rule 17-A of the Companies (General Provisions And Forms) Rules, 1985 (the “Rules”) and sub-section (1) of Section 260 read with Section 255 and 476 of the Companies Ordinance, 1984 (the “Ordinance”) in respect of M/s Khyber Tobacco Company Limited (the “Company”).

2. The facts leading to this case, briefly stated, are that M/s Saeed Methani Mushtaq & Co., Chartered Accountants were appointed as auditors of M/s Khyber Tobacco Company Limited in its Annual General Meeting held on December 29, 2003 to hold office from conclusion of the said meeting until the conclusion of next Annual General



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Meeting. M/s Saeed Methani Mushtaq & Co. made an audit report on the accounts of the company for the year ended June 30, 2004 (the "Accounts") and signed the report on October 1, 2004.

3. The Enforcement Department while examining the balance sheet, profit and loss account for the year ended June 30, 2004 and the reports of the auditors and the directors thereon observed that Auditors report to the members on the accounts was not according to Form 35-A prescribed under Rule 17-A of the "Rules" as the auditors had failed to give an opinion on the statement of Changes in equity. Moreover, the opening paragraph of the report does not state that the profit and loss account, cash flow statement and the statement of changes in equity have been audited. Further examination of the accounts revealed that the auditors while qualifying their report on the going concern issue have erroneously reported negative balance of equity as Rs. 72.04 million (2003: 72.68 million) instead of Rs. 60.029 million (2003: Rs. 60.644 million) as appearing in the balance sheet of the company. The qualification of the auditors on the going concern issue raised the apprehension that the company would not be able to continue as a going concern. The auditors should have expressed an adverse opinion instead of only qualifying their report. For ease of reference the qualification of the auditor is reproduced as under:

"During the current financial year the accumulated losses of the company have reached Rs. 75.40 million (2003: Rs. 75.99 million) and the equity of the company after complete erosion is showing a negative balance of Rs. 72.04 million (2003: Rs. 72.68 million). This along with the adverse long term and short term liquidity ratios and no indication of production plan by the management of the company in the foreseeable future, raises significant doubt about the companies ability to continue as a going concern and the current valuation mode i.e historical cost convention becomes inappropriate as the valuation of assets and liabilities should now be carried out to reflect their net realizable values."



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4. In view of the above circumstances, the Enforcement Department felt concerned about the quality of the audit conducted by Saeed Methani Mushtaq & Co. and the audit report made by them on the account of the company for the year ended June 30, 2004. This necessitated further examination to bring to light as to whether or not the representations and statements made by the auditors to the shareholders were misleading and false.

5. Consequently, a notice dated January 6, 2005 was issued to all the partners of Saeed Methani Mushtaq & Co pointing out clearly their responsibility under the Ordinance and Auditing Standards and prima facie towards misleading statements made by them in their report on the Accounts of the Company. They were called upon to show cause as to why action may not be taken against them for contraventions of the mandatory provisions of law. In response to the show cause notice, Mr. Saqib Rehman Qureshi, FCA submitted a detailed reply through letter dated January 16, 2005. In order to provide an opportunity of personal hearing, the case was fixed on February 10, 2005. Mr. Saqib Rehman Qureshi, FCA appeared and argued the case. At the time of hearing, Mr. Saqib Rehman Qureshi, FCA assumed full responsibility for the audits of the Company and admitted that he had signed the audit report on the accounts for the year ended June 30, 2004.

6. In the written submissions as well as at the time of hearing Mr. Saqib Rehman Qureshi, FCA admitted the defaults. He admitted carelessness on his part while making report in terms of Section 255 of the Ordinance. He assured that these defaults would not be repeated in future. The submissions on his behalf can be summarized as follows:

- (i) He acknowledged the omission of the words “profit and loss account” and “cash flow statement” in the opening paragraph of the audit report. As regards the “Statement of changes in equity” it was contended that it was intentionally omitted from the report as the same was not included in the financial statements by the management of the company who was of the opinion that since the



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change in equity is only due to current years profit, which is already shown in the balance sheet, in profit and loss account as well as in the note 4 to the financial statements, there is no need for the inclusion of statement of changes in equity. Mr. Saqib Rehman Qureshi, however, admitted that as it is a legal requirement and he will be careful in future.

- (ii) As regards inclusion of wrong figures of accumulated losses in the audit report, he admitted the default and assured to be careful in future.
- (iii) As regards going concern issue, he contended that the company is not in production for the last two years as the company is facing contractual problems with one of its main supplier “Pakistan Tobacco Company” (PTC). The Company does not have its own brand and the production is entirely dependent on the orders of the PTC. The only income shown in the financial statements is from re-drying process of tobacco, which is not the main stream of income. Under these circumstances the wording used in the qualification which states that the given condition raise significant doubt about the company’s ability to continue as a going concern is appropriate. He also submitted that the current financial year is the first reporting year in which the issue of going concern was raised and as the situation is still reversible, he issued a qualified report instead of giving an adverse opinion.

7. I have heard Mr. Saqib Rehman Qureshi and have also gone through the submissions and the relevant provisions of law and relevant auditing standards. Mr. Saqib Rehman Qureshi has admitted the defaults except in the matter of going concern issue on which he has contended that since the current financial year is the first reporting year in which the issue of going concern was raised, a qualified opinion was issued instead of



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giving an adverse opinion. In view of the above fact, the argument given by Mr. Saqib Rehman Qureshi on the going concern issue appear appropriate. However, as regards other defaults, it is clear that he has failed to perform his professional duties with reasonable degree of care and skill.

8. 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. 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.

9. 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 is, 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



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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.

10. In view of the forgoing, the lapses, errors and , non-compliances on the part of the auditors cannot be taken lightly. After careful consideration of the conduct of the auditors of the Company and the particular circumstances of this case, I am of the view that Mr. Saqib Rehman Qureshi, FCA has signed the audit report otherwise than in conformity with the requirements of Section 255 of the Ordinance and Rule 17-A of Rules and has made himself liable for punishment under Sub-section (1) of Section 260 of the Ordinance and Rule 35 of the Rules. Accordingly, I impose a fine of Rs 22,000/- (Rupees twenty two thousand only) i.e Rs. 20,000/- (Rupees twenty thousand) under Sub- section (1) of Section 260 of the Ordinance and Rs. 2000/- (Rupees two thousand) under Rule 35 of the Rules on Mr. Saqib Rehman Qureshi, FCA. As Mr. Saqib Rehman Qureshi, FCA has assumed the sole responsibility of the audit of the Company, therefore, no fine is imposed on other partners of Saeed Methani Mushtaq & Co., Chartered Accountants.

11. Mr. Saqib Rehman Qureshi, FCA is directed to deposit the fine of Rs. 22,000/- (Rupees twenty two thousand only) 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.

Ashfaq Ahmed Khan
Director (Enforcement)

Announced
February 14, 2005
ISLAMABAD