

[Islamabad]

Before Ashfaq Ahmed Khan, Director Enforcement

In the matter of

**M/s Jalis Ahmad & Company, Chartered Accountants**

Number and date of notice:	No. EMD/233/211/2002 dated May 17, 2005
Date of Hearing:	June 14, 2005
Present:	<b><i>On Behalf of the Auditors:</i></b>  i. Mr. Iqbal Yousuf, FCA ii. Mr. Faisal Anisuddin, ACA
Date	June 29, 2005

Order

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

This order shall dispose of the show cause proceedings initiated against M/s Jalis Ahmad & Company, Chartered Accountants through show cause notice dated May 17, 2005 under sub-section (1) of Section 260 read with Section 255 and 476 of the Companies Ordinance, 1984 (the "Ordinance") in respect of Al-Jadeed Textile Mills Limited (the "Company").

2. The facts leading to this case, briefly stated, are that M/s Jalis Ahmad & Company, Chartered Accountants (hereinafter called "the auditors") were appointed as auditors of the Company in its Annual General Meeting held on September 20, 2004 to hold office until the conclusion of next Annual General Meeting. The auditors made their report on the accounts of the Company for the year ended September 30, 2004 (the "accounts") on January 11, 2005.

3. The Enforcement Department examined the accounts of the Company 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. It was observed that the auditors have given matter of emphasis on the following issues:

- a. The Company's operation has ceased since long and accumulated losses of the Company as at balance sheet date amounted to Rs.59,459,922/- thus causes a net capital deficiency of Rs.29,459,922/-. These financial statement casts a significant doubt on the Company's ability to continue as a going concern.*
- b. In view of the note no.12.1 of these financial statements, the balance appearing in the head workers profit participation fund that was outstanding since long and no efforts have been made for its proper disposal.*
- c. Long term deposits, trade deposits, export rebate and sales tax refundable remains unverified. In the absence of information we were unable to verify the recoverable amount of the above assets.*
- d. We did not receive any response from Company's legal Advisors and are unaware of any degree of potential financial exposure, claims, litigation or suits filed against or by the Company.*
- e. The Company has not been taken any steps for compliance of the Code of Corporate Governance as required by listing regulation No. 37 of the Karachi Stock Exchange.*

4. The examination of the accounts, however, revealed that the auditors have failed to discharge their duties with regard to following deficiencies and irregularities:

**4.1). Going Concern**

The Company has suspended its operations since 2002. As on September 30, 2004, its accumulated losses stood at Rs. 59.459 million which have resulted in net capital deficiency of Rs.29.459 million. These circumstances gave rise to significant doubt regarding the Company's ability to continue as a going concern. It was stated in Note 1.2 of the accounts **that the Company is no longer considered to be a going concern.** **Further, at Note 1.4 it was disclosed that the accounts were prepared on going concern basis.** The Company did not explain the appropriateness of using going concern assumption in preparation of the accounts, **yet the auditors did not modify**

**their opinion to give an adverse opinion** as provided in Para 35 of International Standard on Auditing (ISA)-570.

**4.2). Reference to the previous Auditor's Report**

The accounts of the Company for the year ended September 30, 2003 were audited by M/s. Avais Hyder Zaman Rizwani, Chartered Accountants, who in their report dated August 30, 2004 expressed **an adverse opinion** due to going concern, non-verification of certain assets and liabilities, non-compliance with IAS-16 & IAS-19, non-response from legal advisors and non-compliance with the Code of corporate Governance. However, the auditor's failed to refer to the report of previous auditors to mention that the financial statements of prior period were audited by another auditor, date and type of report, and reasons for modification, as provided in Para 17 of ISA -710.

**4.3). Other non-Compliances**

- i. *The requirements of IAS-19 were not followed.*
- ii. *The disclosure of Financial Assets and Liabilities for the corresponding year was incomplete.*
- iii. *A penalty of Rs. 20,000 under section 160 of the Ordinance was imposed on the Chief Executive of the Company vide this Commission order dated April 20, 2004. The Company has not disclosed this fact in the accounts as required by clause 4 of Part I of 4<sup>th</sup> Schedule to the Companies Ordinance, 1984.*
- iv. *The Company did not disclose the accounting policy for impairment & borrowing cost.*

5. In view of the above the Enforcement Department felt concerned about the quality of the audit conducted by the auditors and the audit report made by them on the accounts of the Company. Consequently, a notice dated May 17, 2005 was issued to all the partners of M/s Jalis Ahmad & Company. In response to the show cause notice, Mr. Faisal Anisuddin, a partner of M/s. Jalis Ahmad & Company, through his letter dated May 23, 2005, submitted a detailed reply and assumed full responsibility for the audit of the Company. Another letter was received from Mr. Iqbal Yousuf who requested for exemption in the case as he was not involved in the audit of the Company. In view of the fact that Mr. Faisal Anisuddin assumed full responsibility of audit, the request of Mr. Iqbal Yousuf was acceded to. In order to provide an opportunity of personal hearing, the case was fixed on June 14,

2005. On the date of hearing, Mr. Faisal Anisuddin along with Mr. Iqbal Yousuf appeared before me to argue the case and also submitted a written reply. The submissions made by the auditors are discussed as under:

**5.1). Going Concern**

*Since the going concern assumption was not appropriate, the entity's management concluded that the financial statements need to be prepared on an alternative basis, and we determined the alternative basis as appropriate. An adverse opinion or a qualified opinion should be expressed when the going concern assumption used in the preparation of financial statements is inappropriate and/or adequate disclosure is not made in the financial statements. However, in this case the accounts of the Company have not been prepared on going concern basis as stated in note 1.4 rather on an alternative basis which is appropriate in the circumstances and therefore an auditor can issue an unqualified opinion. Further, an adverse opinion should be given in the circumstances when there is disagreement on accounting policies and/or there is an inadequate disclosure in the financial statements, whereas, in this case neither we have any disagreement on accounting policies **except note 1.4 (wherein it is stated that the accounts have been prepared on going concern basis)** nor there was any inadequate disclosure which was so material or persuasive to lead to an adverse opinion. Further, the Company has sold majority of its assets, has made provisions for some assets and has also paid majority of its liabilities therefore we believed that entire adjustments relating to the recoverability of recorded assets and liabilities was made in the accounts and the accounts were brought to their true and fair value as at the balance sheet date, therefore, we didn't feel any need to express an adverse opinion on the accounts. We expressed a qualified **opinion on the accounts of the Company. However, it is agreed in principal that the opinion paragraph should have been modified in a manner to mention the qualifications mentioned in the preceding paragraphs of the audit report.***

The reply of the auditors does not appear satisfactory as the accounts of the Company clearly states that these have been prepared on going concern basis and do not include any adjustments relating to recoverability and classification of recorded assets and liabilities. In case accounts are prepared on net realizable value, then all assets are recorded at their respective realizable value and the difference is taken into profit/loss and all known liabilities are recognized in the accounts in order to reflect the present state of affairs. Moreover, no classification of current and non-current assets and current and long term liabilities are made in the accounts. No such adjustments have been seen in the accounts of the Company, therefore, the plea of the auditors that the accounts have been prepared on alternative basis i.e. NRV, is not tenable. Para 35 of ISA-570 requires that *if in the judgment of the auditor the entity will not be able to continue as a going concern, the auditor should express an adverse opinion if the financial statements have been prepared on a going concern basis.* In the present case, the auditors, at the time of hearing, have admitted that the Company is not a going concern and that they had a disagreement with the management on preparation of the accounts on going concern basis. Therefore, they should have given an adverse opinion as the accounts, prepared on going concern basis, do not give a true and fair view. The auditors argument that the Company has brought the accounts to their true and fair value as at the balance sheet date by making adjustments relating to recoverability of recorded assets and liabilities has no substance. The auditors, in Para (c) of their report, have mentioned that they were unable to verify the recoverable amounts of long term deposits, trade deposits, export rebate and sales tax refundable. These assets, whose recoverable amounts remained unverified by the auditors, are about 86% of the total assets of the Company as on September 30, 2004. In such a situation, it cannot be claimed that the assets and liabilities have been brought to their true and fair value.

Further, the auditor's argument that the report was qualified is also untenable because a qualified opinion should be expressed as being "except for" the effects of the matter to which the qualification relates as provided in Para 37 of ISA -700. The auditors have admitted that the **opinion paragraph should have been modified in a manner to mention the qualifications mentioned in the preceding paragraphs of the audit report.**

In the auditors report to the members, the auditors have admitted that the audit has been conducted in accordance with the auditing standards as applicable in Pakistan. However,

in this particular case they have not expressed their opinion in accordance with the ISAs.

**5.2). Reference to the previous Auditor's Report**

*Non-compliance admitted.* Since the auditors have admitted the default, therefore, the issue needs no deliberation.

**5.3). Other non-Compliances**

The auditors have given following responses:

- a. *The number of employees has reduced to only 3 and adequate provision is available in the financial statements to cover any liability if actuarial valuation is carried out.*
- b. *There was no inadequacy in the disclosure of financial assets and liabilities in the current financial year.*
- c. *The penalty has been disclosed under the head "Fine and penalties".*
- d. *Since almost entire fixed assets have been disposed of and liabilities paid off therefore no question arises in respect of disclosure relating to accounting policy for impairment and borrowing cost.*

The aforementioned contentions raised by the auditors are discussed in seriatim below:

- a. The plea is untenable; it should have been disclosed in the accounts that adequate provision is available in the financial statements to cover any liability if actuarial valuation is carried out.
- b. The comparative figures of financial assets and financial liabilities have not been disclosed in the accounts as required by Para 38 of IAS-1.
- c. The penalty was imposed on the Chief Executive of the Company and he was required to deposit the same from his personal resources. In this case the Company has included this amount in the expenses of the Company and the auditors have failed to bring this fact to the knowledge of the shareholders, instead they have reported that *the expenditure incurred during the year was for the purpose of the Company's business.*

- d. As long as the accounts are prepared on going concern basis all material accounting policies should have been disclosed.

6. 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.

7. 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.

8. Now reverting to the present case, it is clear from the preceding paragraphs that the auditors had failed to perform their professional duties with reasonable degree of care and skill. Moreover, at

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*Enforcement Department*

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the time of hearing, the auditors admitted almost all the defaults. It is therefore viewed that the auditors have committed a breach of fiduciary duty cast upon them by the shareholders. 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. Faisal Anisuddin, the engagement partner has signed the audit report otherwise than in conformity with the requirements of Section 255 of the Ordinance and has made himself liable for punishment under Sub-section (1) of Section 260 of the Ordinance. Accordingly, I impose a fine of Rs 20,000/- (Rupees twenty thousand only) under Sub-section (1) of Section 260 of the Ordinance on Mr. Faisal Anisuddin, ACA who was the engagement partner and was responsible for the default.

9. Mr. Faisal Anisuddin is directed to deposit the fine of Rs 20,000/- (Rupees twenty 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 receipted bank voucher to the Securities and Exchange Commission of Pakistan.

*Ashfaq Ahmed Khan*  
Director (Enforcement)