



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

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Before Mr. Tariq Bakhtawar, Director Enforcement (Company Law Division)

In the matter of

M/s Muhammad Ayub & 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/CO.233/542/02 dated July 11, 2006
Date of hearing	July 31, 2007
Present	Mr. Muhammad Ayub, partner, Muhammad Ayub & Co. Chartered Accountants
Date	September 18, 2007

ORDER

This order shall dispose of the proceedings initiated against M/s Muhammad Ayub & Co., Chartered Accountants (hereinafter referred to as the "Auditors") through show cause notice dated July 11, 2006 under sub-section (1) of Section 260 read with Section 255 and 476 of the Companies Ordinance, 1984 (the "Ordinance") for making reports to the members of M/s Muslim Ghee Mills 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. M/S Muhammad Ayub & Co. Chartered Accountants is a sole proprietary firm and the partner Mr. Muhammad Ayub, FCA is a practicing member of the Institute of Chartered Accountants of Pakistan (the "ICAP").

2. The Auditors have audited the accounts and books of accounts of the Company and have made audit reports on the financial statements of the Company for the years ended June 30, 2003, June 30, 2004 and June 30, 2005 on August 24, 2005 which were presented before the shareholders in the general meeting held on September 30, 2005, pursuant to Commission's direction for holding the overdue AGMs after court recalled its winding up order against the Company.



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3. The Enforcement Department reviewed whether Auditors' reports pertaining to the aforesaid financial years have 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. **It was noticed that audit reports on accounts for the years 2003 and 2004 contained the following qualifications and audit report on accounts for the year 2005 contained a clean opinion with a qualification about non-charging of depreciation:**

Quote:

I.

i. *the operations of the Company has been closed since July 16, 1996. The accounts of the Company have been prepared on a going concern basis the validity of which is dependent on the ability of the company to successfully contest the suits filed by the company's banker for the recovery of their dues and the ability of the Company to obtain further finances and successfully settle insurance claims.*

ii. *The stocks were burnt and destroyed totally in a fire on July 16, 1996 in the factory premises. The company lodged the claims for these losses to the tune of Rs. 8,847,000 on stocks, spares and stores with the insurance company out of which Rs. 5 million was paid by Universal insurance Co. limited to National Bank Limited and the balance amount Rs. 3.847 million is still pending.*

iii. *In the event of failure in either of the above situation, the basis adopted would not be valid and adjustments will have to be made for any gain or loss on realization of assets and liabilities.*

II. We were not authorized to circularize confirmation to Company's bankers, lessors and insurance company regarding present status and terms and conditions of long term loan, short term loans, running finance, leased finance and insurance claim settlement. In absence of this information the terms and conditions given are as per management representation.

III. No depreciation has been provided on fixed assets lying at factory including which have been destroyed, on grounds that assets were not used during the year.

Unquote

4. After examination of audit reports in the context of underlying facts it was apprehended that the Auditors had failed to appropriately modify all the aforesaid reports, with respect to the going concern issue inspite of having knowledge of following facts seriously negating the management's assessment of going concern assumption.

- o The accumulated losses on the relevant year ends stood as follows:

	2005	2004	2003
Accumulated losses	33.974	30.863	30.742
Net Capital deficiency	7.974	4.863	4.742



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- The Company had closed its operations since 1996 due to extreme financial constraints. And winding up proceedings under Section 309 of the Ordinance were initiated by the Commission. This resulted in winding up ordered by the Court, however subsequently the Court recalled its order and the Company was provided with an opportunity for revival vide Court order dated 21.06.2005. The Commission then directed the Company to hold overdue AGMs, submit its financial statements and revival plan within 7 days of its letter dated 4.08.2005. Audited accounts for the years 2003, 2004 and 2005 were then submitted by the Company; however no revival plan was ever submitted.
- Management perspective on the going concern uncertainty including future outlook as noticed from the Directors report dated September 2, 2005 was as follows:

Quote

“The Company closed down its production activities on July 16, 1996 due to fire broke out in the factory premises. Management believes that all the assets are in a repairable condition. The intention of the management is to run the unit as soon as insurance claim is settled by the insurance company. No depreciation is being provided on the grounds that the assets are being looked after properly. As per agreement with creditors the Company is making payment and one of the creditors M/s Crescent Standard Investment Bank Limited has been paid in full and certificate of clearance has been issued by them on 07/04/2005. Our Chartered Accountant is in the process of preparing a plan for the revival of the Company and Unit which will be submitted to the Board of Directors for its approval in October 2005. You will appreciate that litigation between the Company, insurance Company and the bank has ended and directors have injected fresh funds into the Company.”

Unquote

5. In view of above, a show cause notice was issued to the Auditors on June 27, 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.
6. In response to the SCN written representations were submitted by the Auditors, which were followed by a personal hearing held on July 21, 2007. The submissions made by Auditor against the SCN are summarized as under:



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“The management prepared the accounts for the year ended on June 30, 2005 on going concern basis. Accounts for the previous years were also prepared on same basis. Reasons for not qualifying the accounts are as follows:

- After settlement with NBP the Company’s situation has been changed. The management was not having any intention to wind up the Company but ready to inject further capital as well as arranging fresh capital from financial institutions and other parties as shown in the management letter.
- The only main creditor for the Company was NBP. The Company availed the relaxation from State Bank of Pakistan through SBP-BPD circular 29. The dispute between the Company and NBP was settled vide SBP dated October 14, 2004.
- For revival of the unit, management obtained quotations Repair and Replacement of the Plant and Machinery, and Service of professional persons were hired in order to give requirements of the fund.”

7. Perusal of written reply and subsequent hearing revealed that following vital facts which required consideration by the auditors while forming their assessment on going concern assumption were ignored and some basic audit procedures were not followed:

- i. Management representations regarding the Going concern assumption stated to be relied upon by the auditors is as follows:

“We have arranged finance from our own sources and started working for revival of the unit. We have obtained quotations for the repair and replacement of plant and machinery. We are injecting funds and are also approaching financial institutions and other parties for arranging finances.”

Audit evidence in support of the aforesaid representation should have comprised the following [paras 28 and 29, ISA-570 Going Concern]:

- Analyzing and discussing cash flow, profit and other relevant forecasts with the management.
- Analyzing and discussing entity’s latest available interim financial statements
- Inquiring the entity’s lawyer regarding the existence of litigation claims.
- Any negotiations with financial institutions and other parties for arranging finances.

Para 26 of the Standard requires that when events and conditions are identified which may cause significant doubt on the entity’s ability to continue as a going concern, the auditor should:

- a) Review management’s plans for future actions based on the going concern assessment;



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b) *Gather sufficient appropriate audit evidence to confirm or dispel whether or not a material uncertainty exists through carrying out procedures considered necessary, including considering the effect of any plans of management and other mitigating factors; and*

c) *Seek written representations from the management regarding the plans for future actions.* Neither the written reply nor auditor in personal hearing indicated any of the aforesaid procedures. Bids called by the Company for Repair of its machinery were considered sufficient appropriate audit evidence by the auditor, which they are not.

ii. The winding up proceedings initiated by the Commission were recalled by the Court with following direction:

“However, in case the respondent Company defaults on any of the counts on which this petition is moved, the Commission may proceed under Section 309 of the Companies Ordinance, 1984 and the registrar may bring fresh petition if so directed by the Commission.”

Non-existence of business plan on the date of reports suggested that the revival of business was not possible in the near future and winding up threat was not mitigated.

iii. As regards the settlement with major creditors National Bank of Pakistan dated August 10, 2005 following clause of the agreement reflected severity of material uncertainty regarding going concern assumption:

“In case of any single default in payment of settlement installment, the above arrangements would be cancelled and Bank would be entitled to recover entire outstanding liabilities.”

iv. Auditors’ assessment of going concern assumption extends to one year from the close of its financial year. Directors’ report on the accounts for half year ended December 31, 2005 dated January 3, 2006 also reviewed by the same auditors, contained disclosure about potential sale of assets it was stated that “the present condition of the machinery and building is not in this position to start the production.” Later it was discovered that agreement for sale of assets was entered into on 15.12.05. Subsequently, as per its interim accounts for the quarter ended March 31, 2006 its operations were still not revived, rather it had proceeded with the sale of its entire assets. It is clear that management assessment of going concern assumption at respective year ends was incorrect and so were the audit opinions.

8. On the foregoing, I am convinced that the going concern assumption was not appropriately used by the management and the management never had a tangible plan to restart operations. Incorrect assessment of going concern assumption coupled with non-charging of depreciation and un-confirmed balance of liabilities were issues significant enough to call for an adverse opinion on accounts of each of the three years. The Auditors, inspite of failure to verify the management assertions failed to express adverse opinion in their reports accordingly.



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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. 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, makes 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. 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 contradictory and misleading information to the members and, in this way, had failed to perform their professional duties with reasonable degree of care and skill. They knowingly and recklessly gave a clean bill of health to the Company's



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accounts. Auditor's statement that his opinion is based on the representations made and documents/information provided by the management does not justify the lapses committed in discharge of a fiduciary duty and request for a lenient view cannot be validated. However, Mr. M. Ayub pledged to be vigilant in discharge of his responsibilities in future and requested for a lenient view of default.

12. 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. Muhammad Ayub proprietor of Muhammad Ayub & Co. Chartered Accountants has signed the audit reports 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. For this reason, I impose a fine of Rs.5,000 (Rupees five thousand only) under Sub-section (1) of Section 260 of the Ordinance on proprietor of M/s Muhammad Ayub & Co., namely, Mr. Muhammad Ayub 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 years ended June 30, 2003, 2004 and 2005.

13. Mr. Muhammad Ayub is directed to deposit the 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 receipted bank voucher to the Securities and Exchange Commission of Pakistan.

Tariq Bakhtawar
Director Enforcement