



Corporate Supervision Department
Company Law Division

Before Tahir Mahmood – Commissioner (Company Law Division)

In the matter of

• Manzoor Hussain Mir, Chartered Accountant - Auditor of Kohinoor Power Company Limited

Number and date of notice: EMD/233/404/2002-1090 dated March 1, 2013
Date of hearings: July 2, 2015
Present: Mr. Manzoor Hussain Mir

ORDER

UNDER SECTION 260 READ WITH SECTION 476 OF THE COMPANIES ORDINANCE, 1984

This order shall dispose of the proceedings initiated against Mr. Manzoor Hussain Mir, Chartered Accountant, (the "respondent") who was auditor of Kohinoor Power Company Limited (the "Company") for the year ended June 30, 2012. The proceedings were initiated through show cause notice ("SCN") dated March 1, 2013 issued under the provisions of section 260 read with section 476 of the Companies Ordinance 1984 (the "Ordinance").

2. The brief facts of the case are that the respondent conducted the audit and signed the auditor's report dated October 10, 2012 on the Accounts of the Company. The said auditors' report did not appear to have been drawn out in compliance with the requirements of section 255 of the Ordinance, Form 35-A of Rule 17 (C) of the Companies (General Provisions and Forms) Rules, 1985, (the "Rules") and International Standards on Auditing ("ISAs"). Further, regarding the following, the respondent, prima facie, failed to adequately modify his opinion:

- ✓ The respondent gave observations regarding discrepancies in accounting policy and accounting treatment pertaining to the determination of useful life of the plant, impairment loss, depreciation charged, provision of taxes and penalties and issue of going concern.

It, prima facie, failed to record proper opinion as required in the provisions of para C and the corresponding note 4 of the Form - 35(A) of the Rules. It rather contained suggestions to the management about the accounting policies and accounting treatment.

- ✓ The Company's sales for the year substantially decreased to Rs282.312 million from Rs810.519 million, Rs747.919 million and Rs737.622 million for the years ended on June 30, 2011, 2010 and 2009, respectively. Moreover note 30 to the Accounts described that electricity purchase agreements with Lahore Electric Supply Company ("LESCO") and Faisalabad Electric Supply Company ("FESCO") had expired. The apparent uncertainty



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that existed regarding the use of going concern assumption by the Company due to the fact that it lost its key customers, was not appropriately addressed by the respondent, who in his report only gave a very brief reference to the respective note to the Accounts.

In view of the above, it appeared that the respondent in his audit report, prima facie, failed to bring out material facts about the affairs of the Company, as per requirements of sections 255 and 260 of the Ordinance and ISA 570. Consequently, the SCN was issued to the respondent under section 260 read with section 476 of the Ordinance.

3. In response to the SCN, the respondent vide letter dated March 27, 2013 submitted reply.

A brief of his submissions with reference to the contents of the SCN is given below:

- The respondent explained that the word "opinion" is defined as someone's thinking about something that may or may not be accurate and yet represents the honest observation of the person expressing it. It involves exercise of discretion in determining conflicting considerations and opinion of a person about a thing may or may not be in agreement with the opinion of another person. The respondent also referred to various case laws where opinions of different courts were different on similar matters. Taking this stance the respondent explained that there no exception to the opinion rendered by auditor on the accounts and such opinion can vary from one auditor to another.
- The respondent reiterated that the opinion expressed by him was not *malafide*. The additional information contained in the attention note to shareholders provided adequate information to the readers. The usefulness of the information contained in the 'attention -note' in the auditor's report is apparent from the fact that the subject proceeding have been initiated based on it.
- As explained in section 255(3) of the Ordinance, any document, statement or remarks made on financial statements by an Auditor shall be deemed to be a part of auditor's report. Therefore, 'attention notes' cannot be read in isolation but these are to be examined along with other related notes appearing in financial statement for the year.
- Being knowledgeable about affairs of the company in past years, current year and having information about company's future events, the auditor is the appropriate person who can express an opinion on the financial statements after evaluating the audit evidence. It is auditor's privilege and discretion to decide whether to express a qualified opinion, an adverse opinion or drawing attention of shareholders by adding emphasis of matter para in the report. It is of course desirable that auditor would correctly report on financial statements but at the same time it is equally obligatory that he will not make any irresponsible observation.
- While doing audit job, utmost care was taken on the matter of going concern. The respondent gave example of his 'audit report' in the case of another company namely, 'Mian Textile Industries Limited' and emphasized that all the matters were adequately addressed in that report.

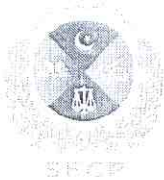


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- The respondent also highlighted that he qualified the audit report of the Company for the year ended June 30, 2004 on various counts including amounts due from associated company including delayed payment charges, rate of mark up / interest on the due amounts, discounts allowed to associated company and actuarial valuations under IAS-19. (However, analysis reveals that only emphasis of matter para was added in respect of going concern). Subsequently, due to improvement, the unmodified reports were issued on subsequent accounts.
- The matter of going concern was duly and adequately addressed. Company's balance sheet shows equity's credit balance of Rs349.510 million, current assets amounting to Rs.185.564 million, which are more than four times of current liabilities amounting to Rs46.058 million. Stock and spares are amounting to Rs66.693 million while cash and bank balances stood at Rs25.699 million.
- As earlier communicated on 08.12.2012, the business was suspended due to non-renewal of agreements with WAPDA and the management was hopeful of obtaining the business in near future. The management in its representation did not show attention to abandon the business, rather in the note to accounts, it is stated that there was definitely demand of electricity from FESCO. The Company is almost a debt-free and has earned profits in the earlier years and can generate electricity at economically. Owing to its potential to earn profits and resume its generation capacity in the near future, the company is a going concern. In view acute electricity shortage in the country, management's assertion cannot be overturned; therefore, the auditor accepted it. It is desirable that auditor would correctly report on financial statements but it is equally obligatory that he would not make any irresponsible observation.
- In respect of accounts for next six months period ended 31.12.2012, the company was asked to explain and adduce evidence regarding renewal of supply agreement but response was not encouraging, consequently the matter was reported in 'audit/ review report' dated 28.02.2013 in following words:
"The Company has not been able to obtain contract for supply of power in the six month period while it has sustained loss of Rs31.501 million (Dec. 31, 2012: Rs.41.082 million). Accumulated losses are Rs77.491 million (Jun. 30, 2012: Rs.45.990 million). This situation creates a material doubt about the going concern status of the company".
- Thus reports on annual and half yearly accounts were issued keeping in view the information available at the material time. The short coming, if any, was not intentional, deliberate or conscious.
- With regard to levy of taxes and penalties, it is stated that in the 'attention that these taxes were subjudice before the courts and hence could not be commented on. It was considered sufficient to disclose the matter in the notes to accounts to invite the attention of shareholders instead of expressing an opinion due to legal embargo. The taxes not having been finally determined were rightly shown and classified as contingent liability and the amount involved Rs11.855 million was merely 3% of liabilities of Rs404.411 million, not material enough to render a qualified opinion.



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- With regard to the objections regarding impairment loss and depreciation, there was no difference in viewpoint of the auditor and the company. The brief facts are:
 1. Usefulness life of the plant was assessed by an 'independent qualified consultant' in the year 2000 for 20 years.
 2. Depreciation rate is being provided @ 5% keeping in view the usefulness life of machinery.
 3. Thus adequate provision depreciation is being made from year to year and charged to revenue.
 4. Adequate expenditure in each year was incurred on replacement of damaged spare parts as is evident from the enclosed chart.
 5. Normal repairs a maintenance expense was incurred from year to year.
 6. Still 8 years of usefulness life of plant are there.
 7. The 'power generating plant' was imported in 1990 and 1991 when the foreign exchange rate roughly was Rupees 30 to a Dollar while in the present days it stands at Rupees 100 to a Dollar. Original cost of 'plant Et machinery' on 30.06.2012 stands at Rs.496.055 million while it's written down value is Rs.199.605 million. You will kindly appreciate that the value of 'plant' imported 20 years back has gone up by 3 to 4 times on account of continuation inflation in the foreign currency rates. As stated above, the 'plant' is appearing in books at original cost reduced by the amount of depreciation; therefore, the question of impairment loss does not arise at all.Year-wise position of spares consumed, general repair a maintenance expenses and depreciation provided would show that adequate expenses were charged to revenue.

Position is summarized below relating to years 2000 to 2012:

	(Rs in million)
Spares, repairs, & Overhauling	188.996
Depreciation	158.826
Capitalization	<u>165.996</u>
	<u>513.818</u>

- Auditor not being an engineer has to rely on the expert for determination of useful life of assets. I have no doubt about the physical position of fixed assets and their depreciation rate as stated above or their original cost. Due care is taken in the preparation of auditor's report regarding legal and factual position.
- In view of the period of 12 years, the management was asked to get it re-assessed to confirm adopted policy; the matter was thus indicated in the attention paragraph to the auditor's report instead of issuing qualified report.

The respondent requested to drop the proceedings based on circumstances of the case he cited.

4. The case was fixed for hearing on June 17, 2015, which was rescheduled based on the respondent's request and was finally held on July 17, 2015. The respondent appeared before the undersigned on the appointed date and made verbal submissions mainly reiterating his earlier written submissions. Additionally he also produced some documents including petition dated June 4, 2012 in terms whereof the Company sought permission from the National Electric Power



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Regulatory Authority ("NEPRA") for modification to its generation license to include FESCO as a power purchaser from the Company. He also provided a copy of NEPRA's decision dated December 12, 2012 whereof the Company's petition was accepted and FESCO was allowed as one of the power purchasers of the Company.

5. Before proceeding further, it is necessary to advert to the following relevant provisions of the Ordinance, the Rules and ISAs.

Rule 17 (C) of the Rules states that, the auditors' report on the accounts and books of accounts and balance-sheet and profit and loss account of a company required by section 255 of the Ordinance shall be on a prescribed format contained in FORM 35-A.

Relevant provisions of ISA 570 regarding auditor's responsibility in respect of going concern assumption are quoted below:

Para 6 states that the auditor's responsibility is to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern. This responsibility exists even if the financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern.

Para 10 states that when performing risk assessment procedures as required by ISA 315 the auditor shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

Para 11 states that the auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. (Ref: Para. A6)

Para 12 states that the auditor shall evaluate management's assessment of the entity's ability to continue as a going concern. (Ref: Para. A7-A9, A11-A12)

Para 16 states that if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional audit procedures, including consideration of mitigating factors.

Para 17 states that the auditor shall conclude whether, in the auditor's judgment, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.



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Para 18 states that *if the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:*

(a) Adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and

(b) Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business. (Ref: Para. A20)

Para 19 states that *if adequate disclosure is made in the financial statements, the auditor shall express an unmodified opinion and include an Emphasis of Matter paragraph in the auditor's report to:*

(a) Highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern; and

(b) Draw attention to the note in the financial statements that discloses the matters set out in paragraph 18. (Ref: Para. A21–A22)

Para 20 states that *if adequate disclosure is not made in the financial statements, the auditor shall express a qualified opinion or adverse opinion, as appropriate, in accordance with ISA 705. The auditor shall state in the auditor's report that there is a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern. (Ref: Para. A23–A24)*

Section 255 of the Ordinance prescribes powers and duties of the auditors and sub-section (3) specifically prescribes the mandatory contents of the audit report.

Section 260 of the Ordinance states as under:

"(1) If any auditor's report is made, or any document of the company is signed or authenticated otherwise than in conformity with the requirements of section 157, section 255 or section 257 or is otherwise untrue or fails to bring out material facts about the affairs of the company or matters to which it purports to relate, the auditor concerned and the person, if any, other than the auditor who signs the report or signs or authenticates the document, and in the case of a firm all partners of the firm, shall, if the default is wilful, be punishable with fine which may extend to one hundred thousand rupees.

(2) If the auditor's report to which sub-section (1) applies is made with the intent to profit such auditor or any other person or to put another person to a disadvantage or loss or for a material consideration, the auditor shall, in addition to the penalty provided by that sub-section, be punishable with imprisonment for a term which may extend to one year and with fine which may extend to one hundred thousand rupees."



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6. I have analyzed the facts of the case, the relevant provisions of the Ordinance, the Rules, requirements of ISAs and the arguments put forth by the respondent. My observations in this regard are as under:

- a) A statutory auditor is bound to follow the requirements prescribed by the Ordinance, the Rules and the ISAs and has to express an opinion remaining within the confines set by them. *The ISAs contain objectives, requirements and application and other explanatory material that are designed to support the auditor in obtaining reasonable assurance. The ISAs require that the auditor exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit.* In terms of the ISAs it is auditor's duty to identify and assess risks of material misstatements, *obtain sufficient appropriate evidence and form an opinion based on conclusions drawn from the audit evidence.* Para 8 of ISA 200 clearly states that *the form of opinion expressed by the auditor will depend upon the applicable financial reporting framework and any applicable law or regulation.* (Ref: Para. A12-A13).
- b) Preparation of financial statements is responsibility of the management and it is auditor's responsibility to express an independent opinion on the financial statements. Any information contained in the notes to the financial statements is a part thereof and cannot be construed as auditor's opinion even though any reference to such notes will be treated as part of the report, in terms of sub-section (3) of section 255 of the Ordinance. Mere reference to disclosure of certain facts in the Accounts does not absolve the auditor of his responsibility to express opinion on the prescribed formats. Moreover, in terms of sub-section (4) of section 255, in case of any qualifications, the auditor is, inter alia, required to state reasons thereof. It is clear beyond doubt that the auditor, in all cases, has to follow the requirements of the law and ISAs. Generalized 'attention notes' given in the audit report without following the form and mode prescribed by the law and the ISAs cannot be considered as sufficient discharge of auditor's responsibility. Auditor can only discharge his duties if he expresses the opinion while remaining compliant to the requirements of the law and the ISAs. Auditor after evaluating the audit evidence expresses his opinion on financial statements but while doing so he has to follow the requirements of the law and the ISAs as these requirements cannot be overruled. In terms of ISA 570 it is auditors' responsibility to remain alert throughout the audit for



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audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and evaluate management's assessment of the entity's ability to continue as a going concern. If the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, then the auditor is required to determine whether adequate disclosure has been made in the Accounts. In case of inadequate disclosure, the auditor is required to qualify the report. In case of adequate disclosure in the Accounts, the auditor must add an emphasis of the matter paragraph in his report to: (i) highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern; and (ii) draw attention to the note in the financial statements that discloses the matters set out in paragraph 18. The auditor in the instant case clearly failed to follow the requirements.

- c) The respondent has referred to the audit opinion expressed by him in case of another company stating that all the matters were adequately addressed in that report. Without commenting on the merit of the statement, it is stated that the matter is irrelevant to the instant proceedings. The respondent has also stated that he qualified the audit report of the Company for the year ended June 30, 2004 on various counts. I have noted that the respondent added an emphasis of matter para in respect of going concern in the year 2004. Nevertheless, that too is irrelevant to the instant proceedings, which pertain to the audit report on the Accounts for the year ended June 30, 2012.
- d) The respondent has reiterated that the matter of going concern was duly and adequately addressed stating the positive equity, current assets exceeding current liabilities etc. He has further stated that the management did not have intention to abandon the business; the Company was almost debt-free with potential to earn profit due to electricity demand in the country and was, therefore, a going concern. The respondent has referred to his report on Accounts of the Company for half year ended December 31, 2002 and has stated that he added emphasis of matter paragraph and adequately addressed the significant doubts about going concern in his review report dated February 28, 2013. The respondent was unable to justify the change in circumstances which led to addition of emphasis of matter paragraph in the subsequent review report. The emphasis of matter



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paragraph has been added at a time when the Company's petition for including FESCO as its customer has been accepted by NEPRA. It is appropriate to refer to ISA 570 which in continuation of its para 10 describes the loss of a key customer(s) or license as an event or condition that may cast doubt about going concern assumption. ISA 570 further requires that if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern; the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists. Since the Company had lost its major customers LESCO and FESCO and sales declined manifold during the year ended June 30, 2012, there was significant doubt about going concern assumption and the respondent was responsible to obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists. Moreover, he was required to determine the adequacy or otherwise of the disclosures made in the Accounts in this regard and give an opinion in line with requirements of para 18 to 20 of ISA 570. In the instant case, it appears from the respondent's submissions that he formed the opinion that adequate disclosures were made in the Accounts. However, he failed to follow the requirements of para 19 of ISA 570 while expressing his opinion as he only gave a very brief reference to the respective note to the Accounts stating, "The management is confident that the Company for all intents and purposes is a going concern for the reasons recorded at note 2.2.1." The respondent did not, however, give an opinion as to whether the management's stance was well founded or not. The respondent did not appropriately address the uncertainty that existed regarding the use of going concern assumption by the Company. Para 18-21 of ISA 570 contain provisions regarding auditor's conclusion on appropriateness of going concern assumption, existence of material uncertainty regarding going concern, adequacy of related disclosures and describe the type of opinion and probable formats to be adopted by the auditor to express opinions accordingly to the criteria set forth by the ISA 570. The respondent clearly failed to follow the requirements in entirety.

- e) I have reviewed the NEPRA's decision dated December 12, 2012 whereof the Company's petition was accepted and FESCO was allowed as one of the power purchasers of the Company. However, no documentation has been provided to substantiate execution of any agreement by the Company with FESCO for purchase of



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power. During the relevant time i.e. year ended June 30, 2012 and at the time of signing of audit report, there was not evidence or documentation to substantiate that the Company had been able to retain its key customers or secured any alternative customers. Moreover, the Company was not able to enter into agreement with FESCO or any other key customers subsequently. As per information available in the file, there has not been any agreement of the Company with FESCO even after elapse of considerable time since the NEPRA's decision.

- f) With regard to observations regarding levy of taxes and penalties the respondent's plea regarding materiality appears to be cogent. However, the basis of the instant proceedings is the inappropriate format adopted by the auditor to record his observations instead of materiality of the issues involved. As highlighted in preceding paragraphs, the auditor is required to follow the requirements of the Ordinance, the Rules and the ISAs and his report must not be in violation of the prescribed format.
- g) In respect of respondent's alleged failure to follow the prescribed format as per the law and ISAs for recording observations on discrepancies in accounting policy and accounting treatment pertaining to the determination of useful life of the plant, impairment loss and depreciation charged, it is viewed that in utter disregard of the prescribed requirements and formats, the respondent gave generalized suggestions in the audit report.

7. Before proceeding to decide the matter, I deem it necessary to make some observations on the role of auditor of a company. The duties and responsibilities of an auditor appointed by the shareholders under the law 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. They elect directors and entrust the affairs of the company to them in the hope that they will manage the company to shareholders' benefits. There is no such arrangement in place whereby the shareholders can have an independent view as to how the directors have managed the affairs of the company. The financial statements are the most important source of reliable information for the shareholders who make their investment decision based on such information. The financial statements not only show the financial position and performance of the company but also show



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the results of management's stewardship of resources entrusted to it. Therefore, correct reporting in the financial statements in line with applicable financial reporting framework is of utmost importance. The law, therefore, recognizing this situation, has provided for the appointment of auditors who shall be responsible to audit the books of account, documents and financial statements required by the law and make out a report on them at the end of each year. This being the only safeguard provided by law to the shareholders to ensure accountability of the management, put the auditors to a high level of accountability in case they fail to make out a report in accordance with the legal requirements. For these reasons, it is of utmost importance for the auditors to exercise due care and diligence in performing their duties and discharging their responsibilities and maintain a high level of trust and integrity at their end.

8. For the foregoing reasons, I am of the view that the respondent in his audit report to members on Company's Accounts for the year ended June 30, 2012 did not appropriately address the uncertainty that existed regarding the going concern assumption and hence failed to bring out material facts about the affairs of the Company. Moreover, the audit report was not in conformity with the requirements of section 255 of the Ordinance, and format provided in the FORM-35(A) of Rules. Therefore, the respondent is liable to penalty under section 260 of the Ordinance. Accordingly, I hereby impose a fine of Rs20,000/- (Rupees twenty thousand only) under sub-section (1) of section 260 of the Ordinance on the respondent.

The respondent is directed to deposit the aforesaid fine in the designated bank account maintained in the name of Securities and Exchange Commission of Pakistan with MCB Bank Limited within thirty days from the receipt of this Order. The respondent must furnish receipted vouchers for information and record, failing which proceedings under the Land Revenue Act, 1967 will be initiated that may result in the attachment and sale of movable and immovable property.



Tahir Mahmood
Commissioner (Company Law Division)

Announced:
September 7, 2015
Islamabad