SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Company Law Division

Enforcement Department

[Islamabad]

Before Ashfaq Ahmed Khan, Director Enforcement

In the matter of

M/s Sarwar Awan & 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 Show Cause Notice:	No. EMD/233/571/2002 January 6, 2005
Date of Hearing:	February 15, 2005
Present:	Mr. Aslam Awan, ACA

Order

This order shall dispose of the show cause proceedings initiated against M/s Sarwar Awan & Co., Chartered Accountants (hereinafter called "the auditors") through show cause notice dated January 06, 2005 under sub-section (1) of Section 260 read with Section 255 and 476 of the Companies Ordinance, 1984 (the "Ordinance") in respect of M/s Mubarak Dairies Limited (the "Company").

2. The facts leading to this case, briefly stated, are that M/s Sarwar Awan & Co., Chartered Accountants were appointed as auditors of the Company in its Annual General Meeting held on January 18, 2004 to hold office from conclusion of the said meeting until the conclusion of next Annual General Meeting. The auditors made their report on the accounts of the company for the year ended June 30, 2004 (the "Accounts") and signed the report on October 9, 2004.

3. The Enforcement Department examined the financial statements of the Company for the year ended June 30, 2004 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. The Enforcement Department observed that M/s Sarwar Awan & Co. have drawn a qualified report on the aforesaid accounts. For ease of reference the qualification of the auditor is reproduced as under:

> *"The company has incorporated in the financial statements surplus on revaluation of fixed assets amounting to Rs. 151,229,064. We are unable to independently verify the correctness of this amount.*
>
> *Loan facilities together with related mark-up amounting to Rs. 211,044,008 remained unverified in the absence of respective bank statements and balance confirmations. Further no mark-up has been charged on the above said loan facilities.*
> *Bank balances remained unconfirmed in the absence of respective bank statements and balance confirmations.*
>
> *The company has not maintained fixed assets register, due to which we were unable to verify existence and valuation of fixed assets.*
>
> *We have not physically verified the store, spares and loose tools. Owing to the nature of the records we were unable to verify existence and valuation of the same.*
>
> *Debtors and creditors remained unverified.*
>
> *Company is not in operations since 1994. It has incurred accumulated losses amounting to Rs. 170.232 million as at balance sheet date. Its current liabilities exceeded its current assets by Rs. 15.203 million. These factors along with default in payment of loans raise a substantial doubt about the company's ability to continue as a going concern. However, the annexed financial statements have been presented on going concern basis."*

4. Further examination and analysis of the qualifications made by the auditors in their report on the accounts for the year ended June 30, 2004 revealed the following:

4.1 **Verification of Assets:** The monetary value of the assets whose existence and valuation was not verified as reported in the aforesaid qualifications amounted to Rs. 239.930 million which is 99.63% of the total assets. These include fixed assets amounting to Rs. 233.994 million, stores, spares and loose tools amounting to Rs. 0.315 million, trade debts amounting to Rs. 5.622 million and bank balances amounting to Rs. 0.006 million. Although, 99.63% assets remained unverified yet the auditors instead of giving an adverse opinion gave a qualified opinion and stated in their report that proper books have been kept by the Company.

4.2 **Verification of Liabilities & Reserves:** The correctness of liabilities and reserves amounting to Rs. 363.40 million was not verified by the auditors. These liabilities and reserves include loans amounting to Rs. 211.044 million, revaluation surplus amounting to Rs. 151.229 million and creditors amounting to Rs. 0.976 million. The liabilities whose correctness, existence and valuation was not verified warranted an adverse opinion.

4.3 **Non-provision for Depreciation:** The depreciation was not charged for the year because the factory remained closed. The treatment was contrary to the requirements of law and Technical Release issued on the subject by Institute of Chartered Accountants. However, the auditors have not qualified their report to the members on this issue.

4.4 **Going Concern Assumption:** The Company is not in operations since the year 1994, and appearently it was no more a going concern yet the auditors did not give an adverse opinion despite the fact that the accounts were prepared on going concern basis.

5. In view of the above the Enforcement Department felt concerned about the quality of the audit conducted by M/s Sarwar Awan & Co. and the audit report made by them on the account of the company for the year ended June 30, 2004. The materiality of the qualifications required an adverse opinion by the auditors who, ***prima facie***, failed to address these issues as per Auditing Standards as applicable in Pakistan.

6. Consequently, a notice dated January 6, 2005 was issued to all the partners of Sarwar Awan & Co. pointing out clearly their responsibility under the Ordinance and Auditing Standards and towards the, ***prima facie***, 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 a detailed reply was submitted through letter dated January 31, 2005. In order to provide an opportunity of personal hearing, the case was fixed on February 16, 2005. However, Mr. Mohammad Aslam Awan, ACA requested for appearance on February 15, 2005 which was acceded to and hearing was held on February 15, 2005.

7. It was stated in the written reply and at the time of hearing that the auditors have discharged their professional responsibility with due care and issued qualified report for the matters which we were in disagreement with the management according to its substance and have requested to withdraw the show cause notice. Attention was also drawn towards the fact the Company had not held its annual general meeting and prepared and submitted its annual accounts since 1997. It was on the direction of the Commission that the accounts for the previous six years were prepared and were audited by the M/s Sarwar Awan & Co. He stated that the Company was lying closed and had no employees except for a company secretary. It was also submitted that Mr. Sharif Awan, FCA being the engagement partner was responsible for the audit of the books of accounts of the Company and signed the audit report thereon.

8. The submissions on behalf of the auditors in writing and at the time of the hearing have been examined in light of the relevant provisions of law and relevant auditing standards and are summarized as follows:

8.1 **Verification of Assets:** It was stated that the fixed assets of the Company have been valued by the appraiser appointed by State Bank of Pakistan's Committee. The appraiser's report verifies the existence and valuation of all fixed assets of the company. In the presence of independent third party confirmation the report has been prudently qualified due to non-maintenance of fixed assets register. It was argued at that the appraised value of the assets is for the purpose of loan settlement and does represent the true worth of these assets and that the fair value needs to be determined. As regards stores, debtors and creditors these balances account for 2% of the total worth and therefore, is not material and persuasive for an adverse opinion.

The submissions of the auditors are not tenable since the report of the appraiser, appointed by the State Bank of Pakistan's Committee, which has been referred to by the auditors as sufficient third party evidence verifies the existence of land, building and plant and machinery whose value only amounts to Rs. 29.995 million whereas the book value of these assets as reported in the books of accounts is Rs. 233.994 million which includes a revaluation surplus of Rs. 151.229 million. Para 29 of International Accounting Standard 16 – Recognition of Property, Plant and Equipment states that *"subsequent to initial recognition as an asset, an item of property, plant and equipment should be carried at a revalued amount, being its fair value at the date of revaluation less any subsequent accumulated depreciation and accumulated impairment losses. Revaluations should be made with sufficient regularity such that carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date."*

It was admitted at the time of the hearing that the fair value of these assets needs to be determined. As regards the existence of these fixed assets in the absence of a fixed assets register it is not possible to verify whether the assets reported in the balance sheet match with those assets which were verified by the appraiser. Hence, it is viewed that a mere qualification that too which does not quantify the amount of adjustments required, is not sufficient. Furthermore, the statement that proper books of accounts as required by the Ordinance are being maintained is contradicted by the qualification in the auditors' report itself which states the Company has not maintained its fixed assets register.

8.2 **Verification of Liabilities & Reserves:** The company has been allowed settlement of loan facilities under SBP's PBD circular 99 as a result the existing loans will be settled at Rs. 23.996 million. Since its implementation has been delayed by ZTBL, the bank liabilities remained unconfirmed.

In the reply the auditors have accepted that the liability have remained unverified. A selected opinion by ICAP states that where the company is not willing to forward auditors' standard request to bankers, or the banks do not reply such requests, the auditor should not issue an unqualified opinion, as inability to obtain bank confirmation constitutes a scope limitation. Para 43 of Auditing Standard 700 (AS-13) – Auditors' Report on Financial Statements *when there is a limitation of scope of the auditor's work that expression of a qualified or a disclaimer of opinion, the auditors' report should describe the limitation and indicate the possible adjustments to the financial statements to the financial statements that might have been determined to be necessary has the limitation not existed.* As such the explanations of the auditors do not appear satisfactory.

8.3 **Non-provision for Depreciation:** It was contended that the assets are accounted for and presented in accordance with the treatment allowed by IAS 16 (para 41) as they have been shown at revalued amount less accumulated depreciation till the company was operational. No depreciation has been charged since the closure of the mills since no economic benefits are accruing to the company.

The submissions in this regard are not tenable because Technical release - 11 issued by the Institute of Chartered Accountants of Pakistan states that *Idle, reserve or stand-by assets should also continue to be depreciated, subject to the periodical review of the useful life of such property, plant and equipment as stated in paragraph 41 to 52 of IAS 16*. Further examination has revealed that the Company had stopped charging depreciation on its assets since 1995-1996. The previous auditors of the Company have qualified their reports on the accounts of the Company for the years ended June 30, 1996 and June 30, 1997 due to non-provision of depreciation.

8.4 **Going Concern Assumption:** The auditors took the plea that Para 33 of Auditing Standard 570 (AS 23) – Going Concern states that if adequate disclosure is made in the financial statements the auditor's shall express an unqualified opinion but shall modify the report by adding an emphasis of matter paragraph.

Reference to Para 33 of Auditing Standard 570 (AS 23) – Going Concern has been made as a justification for providing an emphasis of matter paragraph only. However, Para 35 of Auditing Standard 570 (AS 23) requires the auditor to express an adverse opinion if in the auditors' judgment the entity will not be able to continue as a going concern. In this regard the disclosures in the accounts have been examined and no clear revival plans have been provided. Reference has been made to the settlement of bank liabilities, however, the same remains unimplemented although the matter was resolved by the SBP committee for resolution of disputes vide their letter dated October 01, 2003. Keeping in view the facts that the Company is closed since 1994, has accumulated losses amounting to Rs. 170 million which has wiped out its equity, its current liabilities exceed its current assets by 15.203, no movement has been observed in its debtors and creditors, no revival plans have been indicated and the loan settlement plan has not been accepted by ZTBL, it is viewed that the auditor should have expressed an adverse opinion on the financial statements since these are prepared on a going concern basis.

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.

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 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 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.

11. Before parting with this Order I would like to advert to the fact which has come to light as result of the examination of financial statements of the Company for the previous years. It was observed that Mr. Sarwar Awan, FCA remained a member of the Board of Directors of the Company from 1989 to 1993 and Secretary to the Company from 1989 to 1996. Thereafter, for the year ended June 30, 1997 the firm M/s Sarwar Awan & Co., Chartered Accountants wherein Mr. Sarwar Awan, FCA is a partner, was appointed the auditors of the Company. Subsequently the company defaulted to comply with the statuary provisions regarding filing of interim and annual accounts for six consecutive years. The

Company made good the default regarding the non-filing of annual accounts on the direction of the Commission and submitted its six annual accounts for the years ended June 30, 1998 to June 30, 2003 on December 29, 2003. All of these accounts were audited by M/s Sarwar Awan & Co. Moreover, the registered address of the Company is the same as that of the M/s Sarwar Awan & Co., Chartered Accountants. The situation that one of the partners of the present firm of auditors remained the directors and/or secretary of the Company indicates that they had complete information about the state of affairs of the Company.

12. 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. Sharif Awan the engagement partner has signed the audit report otherwise than in conformity with the requirements of Section 255 of the Ordinance and has made himelf 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. Sharif Awan, FCA who was the engagement partner and was responsible for the default.

12. Mr. Sharif Awan, FCA 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 a receipted challan to the Securities and Exchange Commission of Pakistan.

Ashfaq Ahmed Khan
Director (Enforcement)

Announced
March 03, 2005
ISLAMABAD