



Corporate Supervision Department
Company Law Division

Before Tahir Mahmood – Commissioner (Company Law Division)

In the matter of

**Mr. Muhammad Talib, Engagement Partner F.R.A.N.T.S. & Co., Chartered
Accountants- Auditors of Ahmad Hassan Textile Mills Limited**

Number and date of notice: EMD/233/73/2002-759 dated January 16, 2015
Date of hearing: April 1, 2015
Present: Mr. Muhammad Talib

ORDER

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

This order shall dispose of the proceedings initiated against Mr. Muhammad Talib (the "respondent"), engagement partner of F.R.A.N.T.S. & Co., Chartered Accountants, the auditors of Ahmad Hassan Textile Mills Limited (the "Company") for the years ended June 30, 2013 and 2014. The proceedings were initiated through show cause notice ("SCN") dated January 16, 2015 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 examination of annual audited financial statements ("Accounts") of the Company for the year ended June 30, 2013 and 2014 submitted with the Commission in pursuance of section 233 of the Ordinance revealed that as a result of revaluation of its fixed assets carried out in 2013, the Company had recorded Surplus on Revaluation of Fixed Assets ("SRFA") of Rs644,416,197 out of which Rs624,968,699 pertained to Building, Plant and Machinery and remaining balance of Rs19,447,498 pertained to the freehold land. It was observed that, accounting treatment adopted by the Company was not in line with the requirements of International Financial Reporting Standards ("IFRS") IAS 12- Income Taxes and IAS 16-Property, Plant and Equipment, as stated below:

- i. Deferred tax liability relating to SRFA had not been recognized in the respective Accounts 2013 and 2014.
- ii. The balance of SRFA in the Accounts 2013 and 2014 had not been reported net of deferred tax.

In response to the Commission's queries in this regard, the Company provided information and documents, analysis of which revealed as under:



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- i. Deferred tax liability amounting to Rs65,056,601 relating to SRFA was not recognized in the year 2013 resulting in understatement of deferred tax liability in the Accounts 2013 and 2014.
- ii. The balance of SRFA in the Accounts 2013 was overstated as it was not reported net of the deferred tax liability. The effect was also carried over to the Accounts 2014.
- iii. Amounts transferred from SRFA on account of incremental depreciation was overstated by Rs272,203 and Rs2,908,253 in the Account 2013 and Accounts 2014 respectively due to non-recognition of the deferred tax liability as stated above.

3. The financial impact of the aforementioned contravention with the requirement of IFRS by the Company, as stated above, appeared to be material. However, F.R.A.N.T.S. & Co., the auditors of the Company, did not modify the report and audit opinion on the respective Accounts for the years ended June 30, 2013 and 2014 to highlight the aforesaid non-compliances by the Company. Hence the audit report on the Accounts 2013 and 2014 was, prima facie, not in accordance with the requirements of Section 255 of the Ordinance and International Standards on Auditing ("ISAs") as auditor of the Company failed to bring out material facts about the affairs of the Company. Consequently, the SCN was issued to the respondent under section 260 of the Ordinance.

4. In response to the SCN, the respondent submitted reply vide letter dated February 4, 2015. A brief of his submission relating to the contents of the SCN is as under:

- i. We acknowledge that SRFA was not reported net of relevant deferred tax in the year 2013 and 2014. The non-compliance was merely an oversight on our part and is regretted.
- ii. This unintentional mistake did not have material impact on the net worth of the Company.
- iii. We never intended to mislead the general public or any user of financial statements and the report was not made with intent to profit us or any other person or put another person to a disadvantage or loss or for a material consideration.
- iv. We assure that non-compliance will be rectified retrospectively in the ongoing half yearly review of financial statements as per IAS 8 and in case of non-compliance the report will be modified accordingly.



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Based on the above, the respondent requested for a lenient view and to condone the unintentional mistake and gave assurance for meticulous compliance in future.

5. Subsequently, the case was fixed for hearing which after rescheduling was finally held on April 2, 2015. The respondent appeared in person before the undersigned and mainly reiterated his earlier stance. He further submitted that internal processes of their audit firm were being improved to avoid such omissions in future. He admitted the default and requested for a lenient view in the matter.

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

Para A2 and A 3 of 'Application and Other Explanatory Material' to the International Standard on Auditing 705 "Modifications to the Opinion in the Independent Auditor's Report" ("ISA 705") states as under:

A2. ISA 700 requires the auditor, in order to form an opinion on the financial statements, to conclude as to whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement. This conclusion takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements in accordance with ISA 450.5

A3. In relation to the application of the selected accounting policies, material misstatements of the financial statements may arise:

- (a) When management has not applied the selected accounting policies consistently with the financial reporting framework, including when management has not applied the selected accounting policies consistently between periods or to similar transactions and events (consistency in application); or*
- (b) Due to the method of application of the selected accounting policies (such as an unintentional error in application).*

Para 4 of ISA 705 states as under:

The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when:

- (a) The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or*

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- (b) *The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.*

Para 6 of the ISA 705 states as under:

The auditor shall modify the opinion in the auditor's report when:

- (a) *The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or (Ref: Para. A2-A7)*
- (b) *The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. (Ref: Para. A8-A12)*

Paras 7, 8, 9 and 10 of the ISA 705 prescribe the criteria for determining the type of modification to the auditor's opinion.

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."

7. I have analyzed the facts of the case, the relevant provisions of the Ordinance, requirements of IFRS and ISAs and the arguments put forth by the respondent. I have observed that as per requirements of the Ordinance, IFRS and ISAs quoted in the preceding paragraphs, the auditor was required to modify his report and opinion on the Accounts of the Company for the years ended June 30, 2013 and 2014, in view of the following:

- a) The Company failed to comply with requirements of IFRS as it did not account for the deferred tax impact based on the revalued amounts of its fixed assets in accordance with the requirements of IAS 12 – *Income Taxes* and IAS 16-*Property Plant & Equipment*. The



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Company was required to recognize deferred tax liability relating to the SRFA (excluding land) and the balance of SRFA should have been reported net of deferred tax.

- b) As the Company failed to apply the correct accounting treatment in relation to SRFA and related deferred tax liability as per requirements of IAS 12 and IAS 16, the Accounts 2013 and 2014 were misstated as under:
- i. The balance of SRFA in the Accounts 2013 was overstated as it was not reported net of the deferred tax liability amounting to Rs65,056,601. The effect was also carried forward to the Accounts 2014.
 - ii. Deferred tax liability was understated in the Accounts 2013 and 2014 due to non-recognition of deferred tax liability of Rs65,056,601 relating to SRFA.
 - iii. Amounts transferred from SRFA on account of incremental depreciation was overstated by Rs272,203 and Rs2,908,253 in the Account 2013 and Accounts 2014 respectively due to non-recognition of the deferred tax liability as stated above.
- c) The aforesaid non-compliance with requirements of IFRS have material impact on the Accounts of the Company due to following factors:
- i. Correct accounting treatment in line with requirements of IFRS was not adopted
 - ii. net equity of the Company / breakup value per share was overstated by ~ 4%
 - iii. SRFA balance was overstated by ~7%
- d) The Company is a listed company and has to follow IFRS as are notified by the Commission in the official gazette under section 234 of the Ordinance and there is no contradiction in accounting standards regarding treatment of deferred taxation. IAS 12- *Income Taxes* prescribes the accounting treatment of deferred taxes. Moreover, deferred tax accounting is vital for the fair presentation of the financial statements as it provides accurate calculation of accrual earnings and moderates earnings in accordance with the circumstances that may prevail.

8. For the foregoing reasons, I am of the view that the provisions of section 260 of the Ordinance have been violated by the respondent. However, in view of admission of default by the respondent, his firm commitment to avoid such lapses in future and considering the fact the



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Company's Accounts for the half year ended December 31, 2014 have been restated retrospectively as per requirements of IAS 8, instead of imposing fine, I hereby conclude the case with a stern warning to the respondent to be careful in future regarding compliance with requirements of applicable laws, IFRS and ISAs.

Tahir Mahmood
Commissioner (Company Law Division)

Announced:
April 3, 2015
Islamabad