



**Before Mr. Tahir Mahmood, Executive Director (Enforcement)**

**In the matter of**

**M/s Riaz Ahmad, Saqib, Gohar & Company, Chartered Accountants**

**Under sub section (1) of Section 260 of the Companies Ordinance, 1984 (the “Ordinance”) read with the Companies (Audit of Cost Accounts) Rules, 1998 and Section 255, 258 and 476 of the Ordinance**

Number and date of notice	No. CLD/EMD/FIU/32/2006-3406-7 dated March 3, 2008
Date of hearing	April 18, 2008
Present	Mr. Gohar Manzoor, FCA Partners Riaz Ahmad, Saqib, Gohar & Co. Chartered Accountants
Date	July 17, 2008

**ORDER**

This order shall dispose of the proceedings initiated against M/s Riaz Ahmad, Saqib, Gohar & Co., Chartered Accountants through show cause notice dated March 3, 2008 under sub section (1) of Section 260 read with the Companies (Audit of Cost Accounts) Rules, 1998 (the” Cost Audit Rules”) and Section 255, 258 and 476 of the Companies Ordinance, 1984 (the “Ordinance”), for making reports to the directors of M/s United Sugar Mills Limited ( hereinafter referred to as the “USML”) for the year 2005 and 2006 on the statements pertaining to cost accounting record otherwise than in conformity with the requirements of Section 258 of the Ordinance and the Cost Audit Rules. M/s Riaz Ahmad, Saqib, Gohar & Co., Chartered Accountants (hereinafter referred to as the “Auditors”) is a firm consisting of following partners and was appointed as the cost auditor on December 10, 2005 and November 7, 2006 by the USML for the aforesaid years in terms of the Cost Audit Rules.

1. Mr. Riaz Ahmad, FCA
2. Mr. Gohar Manzoor, FCA



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2. Review, analysis and inquiry into the facts disclosed in the accounts revealed that the funds were siphoned out of USML and the cost accounts were fudged to camouflage the series of fraudulent transaction. These events and transactions could have been identified had the Cost Auditors performed their duties diligently. However, the Cost Auditors reported in their reports, for the years ended on September 30, 2005 and September 30, 2006, that proper cost accounting records as required by clause (e) of sub-section (1) of section 230 of the Ordinance, 1984 (XLVII of 1984), and as required by the applicable rules, including Rule 4 referred to above, have been kept by the company, the said books and records give the information required by the rules in the manner so required; and in their opinion and, subject to best of their information –

- a. the annexed statement of capacity utilization and stock-in-trade are in agreement with the books of account of the company and exhibit true and fair view of the company's affairs; and
- b. Cost accounting records have been properly kept so as to give a true and fair view of the cost of production, processing, manufacturing and marketing of the products of the company.

3. Brief background of the events and transactions is as follows:

- a. Mr. Bashir Ahmed, the unlawfully appointed Managing Agent and Ex-Chief Executive of USML entered into a so-called agreement dated January 17, 2001 with USML purporting to act through its directors Shaikh Abdul Waheed and Shaikh Muhammad Saeed to run/operate and manage the project of USML. Mr. Bashir Ahmed was to be given 53 % profits of the USML as per the profit sharing formula provided in the agreement for which parallel accounts were to be maintained.
- b. Subsequent to a dispute with Ex Directors Mr. Bashir Ahmed filed a suit in the Sindh High Court (the “SHC”) for settlement of his claim amounting to Rs. 446.074 million, which also included receivable against total profit of Rs. 777.765 million for the period 2001-2005 not reported in the audited accounts of the USML. These figures were based on the parallel accounts maintained by the management of USML. The SHC, after giving an opportunity of being heard to the respective parties through its order dated October 7, 2005 made the following directions;

Quote

“The Plaintiff shall submit his claim, along with the relevant record, including books of accounts, ledgers and vouchers etc. to M/s A. F. Ferguson & Co. who are appointed Commissioner for determining the amount due and payable by the defendant Company to the plaintiff under and in terms of the agreements dated 17.01.2001,....”



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..... M/s A. F. Ferguson & Co. shall, after examining and scrutinizing the respective accounts and records, submit their report before the court within five weeks from today and shall supply copies of the report to the parties.”

Unquote

- c. M/s A. F. Ferguson (hereinafter referred as the “AFF”) determined an amount of Rs. 236.885 million payable to Mr. Bashir Ahmed after compilation of data and verification of figures referred by the claimant in the claim, in the following manner.

**Rupees in million**

<b>Components of claim</b>	<b>Claim lodged by Mr. Bashir Ahmed</b>	<b>Claim determined by AFF</b>
Share of “balance profit” payable to Mr. Bashir Ahmed.	202.644	<b>166.873</b>
Amount of loan recoverable from USML	74.712	70.012
Amounts payable to sundry creditors	65.447	-
Expenses incurred during the period April 1,2005 to September 30,2005	103.270	-
Total	446.074	236.885

- d. The claim of Rs. 236.885 million determined by AFF, included share of profit amounting to Rs. 166.874 million. This amount of Rs.166.874 million was charged in the accounts for the year ended September 30, 2006 as other operating expenses / other charges and was not a stand-alone transaction. Infact this was the remaining profit of Mr. Bashir Ahmed out of a total profit of Rs. 777.765 million for 2001-2005 based on the accounts maintained parallel to the audited accounts. The gist of material transactions not reported in the audit accounts and basis for aforesaid profit of Rs.777.765 million are summarized below:

**Rupees in million**



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Misstatements	Implications of previous year			2005	2006
	2002	2003	2004		
Concealment of revenues - out of books sales	25.540	49.532	63.876	82.624	0
Fixed assets overstated and repair & maintenance expenses understated	6.997	57.672	3.452	0	0
“Other operating expenses – other charges” wrongly charged	0	0	0	0	166.873
Payments to USML sponsors against profit.	8.000	13.200	12.000	10.400	0

4. Information / facts disseminated through Cost statements were misleading as the impact of the aforesaid transactions on the cost data for the relevant audit years was not incorporated. Moreover, the Cost accounting statements have not accounted for “other expenses” and “other income” for determining the profitability of the Company for the year ended September 30, 2005 and September 30, 2006. The reconciliation statements regarding the profitability of the Company for the aforesaid years have also not been provided by the auditors in this respect. The cost accounting record maintained by the management of the USML do not reflect true and fair view of the cost of production, processing, manufacturing and marketing of the products of the company for the year ended on September 30, 2005 and September 30, 2006.

5. In view of the above facts, it appeared, prima facie that the auditors have failed to discharge their duties and responsibilities laid down in the Ordinance by not modifying their report in respect of concealment of revenues - out of books sales amounting to Rs. 82.624 million in the year 2005 and Rs. 166.874 million charged as other operating expenses in the year 2006, which impairs the true and fair view of the statement of production, capacity utilization and stock-in-trade annexed with the Cost Auditor Report for the financial year ended on September 30, 2005 and September 30, 2006.

6. Consequently, a show cause notice (SCN) was issued to the Auditors on March 3, 2008 pointing out their responsibilities under the Ordinance, International Accounting and Auditing Standards, the Cost Audit Rules and non-compliances observed in the Accounts. A period of 14 days was given to respond to the aforesaid notice.

7. In response to the SCN, written representations were submitted by the Auditors on April 11, 2008. The contentions made by them are summarized in paragraphs below;



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- a. The scope of Cost Audit as defined by Institute of Cost & Management Accountants of Pakistan in its Cost Audit Handbook is “an examination of cost accounting records and verification of facts to ascertain that cost of the product has been arrived at, in accordance with principles of accounting”. The Cost Audit Rules (format of Cost Auditor’s report given in Appendix-II) and the scope of Cost Audit confines the scope of the cost audit to expressing an opinion as to whether or not to the best of their information the annexed statement of capacity utilization and stock-in-trade are in agreement with the books of account of the company and exhibit true and fair view of the company’s affairs. The cost auditor is obliged to include certain particulars in his report as per Annexure-III attached with the Cost Audit Rules. We have submitted the reconciliation of Cost Accounts with the financial statements for the year ended September 30, 2005 and 2006.
  - b. The auditors have conducted their cost audit strictly in accordance with the relevant laws based on the financial information approved by the audit committee, the board of directors and by the shareholders after being audited by the external auditors of the USML.
  - c. The auditors were totally unaware of the unlawful activities of the previous management or any secret agreement between the Ex-Chief Executive and the Ex management. The appointment of auditors was made on December 10, 2005 and the honorable High Court has already given its instructions vide its order dated October 7, 2005 as per the show cause notice, however these facts were not disclosed to the auditors by the directors. Further by the time the cost auditors were appointed, all the facts were in the knowledge of the Commission. The directors who were addressed with the Cost Audit report were already party to the transaction mentioned in the show cause notices.
8. The auditors further submitted their para-wise reply to the contents of the show cause which are summarized as under;
- a. We have neither been provided copy of the report submitted by AFF nor are aware about the contents of that report. We even do not know the basis on which the figures of concealment, as contained in the show cause notices, have been worked out. We were told that the AFF report is for the use of court only. We are unable to make any comment on the subject report and the order of the court except that presumably, the report has been constructed based on the information and records volunteered by the parties to the illegal agreement. In the absence of such volunteered information, it is near to impossible for the cost auditor to find the concealed facts.



- b. The cost auditor has to verify the basic elements of cost viz. material consumption, wages of worker and overheads ensuring that the cost of production has been arrived at as per principles of cost accounting. The cost auditor is neither conducting investigative audit nor forensic audit so that concealment of revenue could be detected. The role of cost auditor is to analyze cost associated with the product. We have provided state of affairs of the USML on the basis of the record provided to us.
- c. The cost accounting records that are to be maintained by a sugar manufacturing company are laid down in Sugar Industry (Cost Accounting Records), 2001 that do not include record of sales as cost record.
- d. The operating charges of Rs. 166.874 million are not included in the working of “Total cost to Make and Sell” in the statement prepared under Schedule II to the above rules. Further, the total figure of Rs. 166.874 million relates to the period prior to year ended September 30, 2006. The primary responsibility for detection of fraud is that of management (refer Para 13 to 16 of ISA 240 “the Auditor’s responsibility to consider fraud in an audit of Financial Statement”). The other figures like Rs. 12.00 million and Rs. 13.20 million were neither disclosed by the management nor made part of financial statement by the auditor and accordingly it is impossible for the cost auditor to be acquainted with such figures without any specific source of information or knowledge. Any assertion to the contrary is denied.
- e. Regarding the reconciliation statement of profitability of the company, we would like to draw your attention towards clause 15 of the appendix III under rule 4 (3) of the Cost Audit Rules;

*Reconciliation with financial account*

“After the auditor appointed under section 252 of the Companies Ordinance submits his report, the cost auditor shall submit a supplementary report on reconciliation with financial accounts to the directors before the date fixed for holding the general meeting of the company.”

It is clear from the wording of the clause that it does not require reconciliation statement regarding the profitability of the company but requires reconciliation with financial statements that we have submitted with our cost audit reports for both of the years under consideration.

- f. The USML has charged an amount of Rs. 166.874 million in audited financial statement for the year ended September 30, 2006 as “other operating expenses” after decision of SHC while disposing off the dispute that has arisen between the previous sponsors of the USML and Mr. Bashir Ahmed. Since the whole of the amount of Rs. 166.874 million, as disclosed in the



financials statements, relates to the period prior to the year 2006 and has therefore, appropriately been not charged in “Total cost of Make and Sell” in the statement.

- g. In view of the above submission, it is clearly established that the statement of production, capacity utilization and stock-in-trade annexed with our cost audit report for the above referred financial years to the best of our knowledge and belief gives a true and fair view of the state of affairs of the company and cost accounting has been properly conducted in accordance with the relevant law, the rules and the order.

9. In order to provide an opportunity of personal hearing, hearing in the matter was fixed on April 18, 2008. Mr. Gohar Manzoor, FCA, Partner Riaz Ahmad, Saqib, Gohar & Co. Chartered Accountants represented the USML before the undersigned. Written submissions were reiterated by the representative of the USML. During the course of hearing, the representatives reiterated the same arguments as were given through written submissions in response to the SCN.

10. The written representations of the auditor, as well as arguments advanced during the hearing have been considered and have been discussed as follows; -

**a. What is the objective of the cost audit?**

The objective of an audit of cost accounts is to enable the cost auditor to express an opinion whether the cost statements are prepared, in all material respects, in accordance with an applicable reporting framework. Sugar Industry is required to comply with Sugar Industry (Cost Accounting Records) Order, 2001 (“Cost Order, 2001”) and the Companies (Audit of Cost Accounts) Rules, 1998 (“Cost Audit Rules”).

**b. Whether the cost accounts give the information required by the Cost Order, 2001 in the manner so required and give a true and fair view?**

The cost accounting records for the years 2005 and 2006 were not kept properly as required by the Cost Order, 2001 and the cost statements for the years 2005 and 2006 did not give true and fair view of the company as required by the Cost Audit Rules, 1998. The USML was in fact earning profit in these years, however loss was reported in the cost statements and the cost statements were fudged mainly due to the concealment of revenues in year 2005 and overstatement and understatement of stock-in-trade in year 2005 and 2006 respectively.



**c. Cost Auditor statement that he was suppose to verify only the basic elements of cost.**

The cost auditor agreed that he has to verify the basic elements of cost viz. material consumption, wages of worker and overheads ensuring that the cost of production has been arrived at as per principles of cost accounting, however he argued that the cost accounting record do not require to maintain record of sales as cost record. Auditor is acknowledging his responsibilities in respect of the verification of the cost of production, however, he could not demonstrate the same from the audit conducted, as the figures disclosed in the Cost Statement, does not reflect true and fair information including unit cost.

**d. Information / notice of report submitted by A.F. Ferguson & Co.**

The AFF report was a curtain raiser from the activities going on in the USML, and the Cost Auditor could have noticed these activities, had he planned and executed his work diligently.

The SHC appointed AFF as Commissioner on the joint request of the parties in its order dated October 7, 2005, for determining the amount due and payable by the USML to Mr. Bashir Ahmed. AFF determined the amount payable to Mr. Bashir Ahmed, the Ex-Chief Executive after examining and scrutinizing the respective accounts and records and submitted their report in SHC and to the parties.

Court Order Dated October 7, 2005

Quote

“The Plaintiff shall submit his claim, along with the relevant record, including books of accounts, ledgers and vouchers etc. to M/s A. F. Ferguson & Co. who are appointed Commissioner for determining the amount due and payable by the defendant Company to the plaintiff under and in terms of the agreements dated 17.01.2001,....

..... M/s A. F. Ferguson & Co. shall, after examining and scrutinizing the respective accounts and records, submit their report before the court within five weeks from today and shall supply copies of the report to the parties.”

Unquote

Court Order Dated June 21, 2006

Quote

“This is an application filed by the plaintiff in which the plaintiff has prayed that parties may be allowed to receive their respective amount with profits as per report of M/s A. F. Fergusons & Company. Copy of the report dated 30-5-2006 is attached with the application. It is stated that the amount is lying deposited with the Nazir of this court. Mr. Rana Ikramullah, learned counsel for the defendant No. 1 and Mr. Muhammad Shahid, learned counsel for the defendant Nos. 2 & 3 have given no objection on the application. The application is allowed by consent in terms of the prayer for disbursement of the respective amount with profits as per the report of A. F. Ferguson & Company. The application in the above terms stands disposed of”.





Unquote

Audit opinion of the Statutory Auditors for the year ended September 30, 2006

Quote

“The attention of the members was drawn in the audit report towards note 25.2 of the financial statements (for the year ended September 30, 2006), which explains the rationale of the charging an amount of Rs. 166.874 million in the profit and loss statement for the year, payable to the former Chief Executive of the company in accordance with the directions of Sindh High Court vide its order June 21, 2006”.

Unquote

Note 25.2 of the financial statements for the year ended September 30, 2006 gives following disclosure:

Quote

“An agreement was made by the previous sponsors with Mr. Bashir Ahmed on January 17, 2001 for revival of the management and operations of the mills till September 30, 2005. Mr. Bashir Ahmed was appointed as Chief Executive on January 17, 2001 and remained in that office till October 11, 2005.

Following a dispute in this regard to the agreement, Mr. Bashir Ahmed filed a case against the Company. The matter was finally decided by the Honorable Sindh High Court at Karachi, vide order dated June 21, 2006. The compensation decreed by the Court has therefore been incorporated in the financial statements as “Other Charges”.

Unquote

The said AFF report hence becomes the basis of final SHC court order dated June 21, 2006 disposing off the matter through consent, and carries fundamental importance in the disbursement of claim to Mr. Bashir Ahmed. This report along with the respective court orders was available and cost auditors could have accessed this information for understanding the nature of Rs. 166.874 million.

It may be noted that the financial statements and the statutory auditors report were signed on January 8, 2007, whereas the cost auditors have signed their reports much later on January 25, 2007 meaning by that the cost auditor was aware of the disclosures made in the auditor report and audited accounts i.e. agreement between Mr. Bashir Ahmed and USML, subsequent dispute and its settlement under the court orders. Further the cost auditor impliedly admitted that he was aware of the background of the amount of Rs. 166.874 million by not including the amount of Rs. 166.874 million in the “Total cost to Make and Sell” which has been incorporated in the financial statements as “Other Charges”. In their representation they stated;



Quote

“ .....since the whole of the amount of Rs. 166.874 million, as disclosed in the financial statements relates to period prior to the year 2006 and has therefore appropriately been not charged in “Total cost to Make and Sell” in the statement”.

Unquote

- e. **Cost Auditor represented that since Rs.166.874 million, as disclosed in the financial statement, relates to the period prior to the year 2006 and hence therefore appropriately been not charged in “Total Cost of Make and Sell in the statement”.**

Rs. 166.874 million was definitely a window, through which cost auditors could get insight into the events and transactions summarized above and recognize that this cost, as stated earlier, is related to the prior period i.e. up till 2005 where the cost statements for year 2005 were audited by the cost auditor. However, despite being aware of the nature and subsequent impact of Rs. 166.874 million, the cost auditors failed to take appropriate steps including modification of audit report, which have been signed otherwise then in conformity with the legal framework and failed to translate the impact of Rs. 166.874 million on the years being audited. The auditor just complacently stated that it relates to the period prior to the year 2006 and hence therefore appropriately been not charged in “Total Cost of Make and Sell in the statement”.

The cost of production, processing, manufacturing and marketing of the products of the company along with the statement of capacity utilization and value of stocks were incorrect and the cost accounting record of the Company do not reflect true and fair view of the aforesaid, for the year ended June 30, 2005 and June 30,2006.

- f. **Whether in 2005 and 2006 cost audit, Auditors duly discharged their duties and responsibilities.**

Auditors failed to provide documentation / information that were important in providing audit evidence to support the audit opinion that the audit was carried out in accordance with ISA. Cost Auditors were required to plan and execute the audit ensuring the:

- Completeness and accuracy of quantitative data including capacity utilization and stock-in-trade.
- Completeness and accuracy of cost data including cost of production, processing, manufacturing and marketing of the under-mentioned products of the company.

The embezzlements, frauds and misstatements in the cost statements do not support the Cost Auditors' contention that they have adequately designed and applied audit procedures



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to obtain sufficient and appropriate evidence. Had the audit been conducted with the required diligence, these material misstatements would have been identified. This was further substantiated by the inability of the Cost Auditors to demonstrate that the audit was diligently planned and conducted and to provide that elaborate procedures were applied and audit evidence obtained resultantly.

The Industries engaged in the manufacturing of goods in the process based production system, are required to establish a cost accounting system, enabling them to calculate / workout the cost of goods sold, valuation of stocks including raw material, work in progress and finished goods. A diligent review and analysis of the quantitative data and physical flow of the equivalent units at various stages would have enabled the cost auditor to identify the lost units / misplaced quantity. Thus, identification of the quantity embezzled out of the finished goods would have been relatively easier work. However, the cost auditor's representation that relied on the reconciliation with financial statements for verification of cost statements shows that they complacently drawn comfort from the fact that the statutory auditors have duly audited financial statements, and failed to conduct their audit independently. The financial statements referred and relied upon by the Cost Auditor were fudged meaning that the Cost Statements are also fudged defeating the very purpose of maintaining the Cost records and the Cost Audit. The cost auditor failed to perform independent audit procedures to ascertain correctness of the quantitative data including review and analysis of quantitative reconciliations.

The auditors pointed out that there is no omission on the part of auditors who acted upon the books as maintained by the directors of the USML, and duly audited by the statutory auditors. The cost audit reports are in agreement with the books of account and production record as maintained by the company and provided to the auditor. However the cost auditors, being mandated with the powers and duties as of statutory auditors in the Ordinance, were suppose to independently and objectively examine, scrutinize and verify the cost statements and cost data without relying on the work of statutory auditors for expressing their audit opinion. This would enable them to express appropriate opinion on the completeness, accuracy and reliability of cost data on a stand alone basis, based on sufficient and appropriate audit evidence instead of gaining / drawing strength from the work of the statutory audit. Infact the cost auditors were to independently verify the cost data to confirm that the cost figures flowing in the financial statements were correct and presenting true and fair view of the cost of goods sold.



11. Before deciding this case, I deem it necessary to make some observations on the role of Cost Auditors of a Company. The powers, duties and responsibilities of the cost auditor, as stated in section 258 of the Ordinance are similar to that of the statutory auditor of the company. Cost Auditor is responsible to audit and express opinion on the true view and fairness of the Cost Statements. In case, opinion expressed is not correct, the whole exercise will be rendered useless and the user / reader will be deceived. Sugar manufacturing in one of these industries where cost audit is mandatory and cost auditor is responsible to ensure that the information disseminated through Cost statements is true and fair. The Cost Auditor's duty is not only to bring to light the errors of omission and commission but also to detect manipulation in the cost accounts. Beside the fact, the role of cost auditor has been enhanced by requiring him to submit the copies of his report to the Commission, in addition to submit his cost audit report to the directors, that is used by the Commission as a regulatory surveillance tool to keep a check on the listed companies. 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 cost.

12. The USML was stripped off from its assets and revenues in a blatant manner. Mr. Bashir Ahmed, inducted as Chief Executive under a so-called agreement to operate and manage the USML along with the directors of USML, made huge gains from the project while depriving the shareholders of their rightful shares in the profits made out of the project. Parallel / hidden accounts were maintained in accordance with the agreement to record the actual profits to be embezzled later on. The shareholders were deprived from their rightful share in the profits rather they were made liable for the liabilities arising out of the embezzlements.

13. The Auditors had to play important role in developing an insight into this whole plethora of frauds and embezzlement on behalf of the shareholders. However, it is clear from the preceding paragraphs that the Cost Auditors placed excessive reliance on financial information provided by the management and on the reconciliation of cost accounts with the financial statements duly audited by the statutory auditors, and while doing so failed to perform their professional duties with reasonable degree of care and skill. The cost accounting records for the years 2005 and 2006 were not kept properly as required by the Cost Order, 2001 and the cost statements for the years 2005 and 2006 did not gave true and fair view of the company as required by the Cost Audit Rules. It is therefore viewed that the Auditors have committed a breach of fiduciary duty cast upon them. The audit representation affirms that the Auditors were cognizant of their responsibilities that they have to verify the basic elements of cost viz. material consumption, wages of worker and overheads ensuring that the cost of production has



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been arrived at as per principles of cost accounting. The Cost Auditor has acknowledged his responsibilities in respect of the verification of the cost of production, however, he could not demonstrate the same from the audit conducted, as the figures disclosed in the Cost Statements, does not reflect true and fair information including unit cost. Moreover, the alert generated by payment of Rs.166.874 million was not duly taken care off and Auditors did not bother to take notice of the gravity of the situation. They complacently opted for an easy exit without taking appropriate steps to verify the relevant assertions, by giving an opinion that does not correlate with their statement that the amount of Rs.166.874 million pertains to period prior to the year 2006, and to modify their audit report accordingly.

14. After consideration of the facts and circumstances of this case, I am of the view that the Auditors have signed the audit reports otherwise than in conformity with the requirements of Section 255 and 258 of the Ordinance and have committed a default in terms of Section 260 of the Ordinance. However since the Auditors have offered to cooperate with the Commission in the legal recourse against the delinquent management, the partners of M/s Riaz Ahmad, Saqib, Gohar & Company, Chartered Accountants are only reprimanded. Moreover, the Auditors are further directed to take the action appropriate in the circumstances in terms of the effects on the auditor's opinion, including modification of the Cost audit reports.

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**Tahir Mahmood**  
Executive Director (Enforcement)