



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

Before Mr. Ashfaq Ahmed Khan, Director (Enforcement)
in the matter of
Gardezi and Company, Chartered Accountants

No. and date of show cause notice: **EMD/233/75/2004-179-180**
July 7, 2005

Date of final hearing: **September 5, 2006**

Present:

Mr. Sheikh M. Tanvir
Partner
Gardezi and Company

Syed Aftab Hameed
Partner
Gardezi and Company

Mr. Hanif Razzaq
Authorized Representative of
Mr. Hyder Ali Bhimji
Partner
Gardezi and Company

Mr. Walid Khalid
Advocate
Cornelius, Lane and Mufti,
Legal Advisor

ORDER UNDER SUB-SECTION (1) AND (2) OF
SECTION 260 AND SECTION 255 READ WITH
SECTION 476 OF THE COMPANIES ORDINANCE, 1984

This order shall dispose of the proceedings initiated against the Partners of Gardezi and Company, Chartered Accountants through show cause notice dated July 7, 2005 under sub-section (1) and (2) of Section 260 read with Section 255 and 476 of the Companies



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

Ordinance, 1984 (the “Ordinance”) in respect of audit of accounts of Ahmed Spinning Mills Limited (the “Company”).

2. The facts leading to this case, briefly stated, are that M/s Gardezi and Company, Chartered Accountants (hereinafter called “the auditors”) have audited the annual accounts of the Company for the year ended September 30, 2004 and for the period ended June 30, 2005. The auditors made their report on the accounts of the Company for the year ended September 30, 2004 on January 4, 2005 and for the period ended June 30, 2005 (the “accounts”) on October 3, 2005. The Enforcement Department of the Securities and Exchange Commission of Pakistan (the “Commission”) conducted an examination of the Company’s annual accounts for the year ended 30th September, 2004 and observed that the Company sold all of its long-term assets i.e. Property, plant and equipment and long term investment in United Sugar Mills Limited (USML). The auditors in their report for the year ended 30th September, 2004 gave an adverse opinion and doubted the ability of the Company to continue as a going concern. The auditors also highlighted the fact that they were unable to carry out the physical verification of the long term investments as the share certificates were not made available to them. Consequently the same remained unverified. As the Company sold its assets including long term investment i.e. 673,268 shares of USML, in contravention of Section 196(3) of the Companies Ordinance, 1984 (the Ordinance) a show cause notice was issued to the Chairman, Chief Executive and other directors of the Company and a penalty of Rs.100,000 each was imposed on all the directors of the Company under section 196(3) of the Ordinance, which penalty has since been deposited by the directors of the Company. The Investment in shares of USML which was made 22 years ago stood at Rs.9.089 million as on 30th September, 2004, which constituted 61% of the total assets as per audited accounts for the year ended



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

30th September, 2004. These shares were sold to M/s Clearshore Limited of UK through an agreement dated November 10, 2004, which was not reported to the Karachi Stock Exchange as per their listing regulations. The agreement indicates that the price of shares so sold was to be received within six months of the agreement. The market price at the time of receipt of sale money increased to Rs.105 per share on March 29, 2005 which was further increased to Rs.333/- per share during a short span of six months. The accounts of the Company for the period ended June 30, 2005 were also examined to determine, among other things, whether auditor's report on the accounts for the period ended June 30, 2005 had been made in conformity with the requirements of Section 255 of the Ordinance. It was observed that although the auditors had issued an adverse opinion on the accounts of the Company however they failed to draw shareholders attention towards selling of the long term investment in an unlawful manner which matter was qualified in the last year audit report. The auditors, therefore, vide letter no. No. EMD/233/75/2004 dated April 19, 2006, were asked to state as to why shareholders attention was not drawn in the audit report towards selling of the of the long term investment by the management in the year 2005 as the matter was qualified by them in the last audit report. The reply dated May 18, 2006 to the letter was received from the auditors on May 20, 2006. At the outset the auditors informed that they have audited the accounts for the period ended June 30, 2005 in accordance with the provisions of law stating that the Report comprehensively qualified the deficiencies in the financial statements of the Company and based on those qualifications, an adverse opinion on whole of the state of affairs of the Company was also issued.



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

3. As regards the issue of not inviting shareholders attention towards sale of investment in USML in unlawful manner, the auditors submitted as follows:

a. During our audit of the Company for the period ended June 30, 2005, we observed and verified that the said shares had been sold out to a foreign company under a sale agreement duly authorized by resolution of the board of directors. Looking into the documentation as well as the date of transaction (stated / appeared to have been taken place under the peculiar circumstances being faced by the Company where all out efforts were being made to generate liquid funds for the revival of the company's business), we found the sale transaction of such shares in order notwithstanding the fact that the related shares, board's resolution of sale and the sale agreement were not shown to us during our audit of accounts of this company for the period ended on September 30, 2004.

b. Further, the Directors of a Company are empowered in clause (e) of Sub-section (2) of Section 196 of Companies Ordinance, 1984 to invest the funds of the Company while divestment whereof at an appropriate time is an implicit act. As already mentioned in our reply letter to your show cause notice relating to the accounts of this company for the year ended September 30, 2004, the provisions of section 196(3) in our humble submission were not applicable in the instant ease.

4. As regards the issue of not inviting shareholders attention towards factual position about sale of investment in the year 2005, it was stated by the auditors that as the matter was qualified in last audit report and it is not customary to add or reproduce the previous qualifications particularly when the related matter is not carried forward/continuing or



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

otherwise resolved/settled during the period under audit. It was further stated that ‘we had obtained sufficient audit evidences in the form of Sale Agreement, Directors’ Authorization to affect the sale, Letter of Representation (LOR) on the accounts for the period ended June 30, 2005 and after examining the same found no reason to further qualify our report on this matter any more. You will appreciate that qualification on the long term investments as included in our report on the accounts for the year ended September 30, 2004 was on account of the fact that the related shares were not made available to us for our verification to confirm their existence and ownership at that point of time. Such circumstances were non-existent in the period 2005, as the shares were sold out under the sale agreement duly approved and authorized by the board of directors and the sale proceeds their-against was duly received, utilized and shown appropriately in the accounts for the period ended June 30, 2005.

5. As the auditors, prima facie, did not comply with the requirements of law while issuing the audit report dated October 3, 2005, a Show Cause Notice was issued on July 7, 2006 requiring them to explain, in writing, as to why action may not be taken as provided under Sub-section (1) and (2) of Section 260 read with Section 476 of the Ordinance. Prima facie, the auditors contravened the following provisions of the law:

- a. Para 7 and 11 of International Auditing standard (ISA) 500 (Audit Evidence) as the audit evidence could not be termed as Sufficient Appropriate Audit Evidence and was not complete and accurate.
- b. Para 13 of ISA 710 (Comparatives), as stated in para 11 above, does not give an emphasis of matter para on the material issue of sale of long term assets by the Company and which was qualified in the preceding year audit report.



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

- c. Para 49 of ISA 330 (The audit procedures in response to assessed risks) as the auditors failed to assess risk of material misstatement and accordingly design and perform substantive procedures for each material class of transactions including the sale of long term investment by the Company in a non-transparent manner.
- d. Para 24 of ISA 240 (The auditor's responsibility to consider fraud in an audit of financial statements) as they have failed to maintain an attitude of professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist in view of the fact that the share certificate of investments were initially not disclosed to the external auditor and subsequently were sold at a throw away price without information of the shareholders in a non-transparent manner.

6. The auditors in their reply dated August 1, 2006 pleaded that they audited the accounts for the period ended June 30, 2005 and reported inconsistencies in the financial statements and due to severity of matter in both prior periods as well as current period's audit reports earned an adverse opinion which in auditors review sufficiently reflects concerns of the auditors. Further, the planning of the audit, obtaining and evaluating the audit evidence and assertions of the management has been duly carried out including the designing and performing of the substantive procedures. It was further informed that the emphasis of matter para on the issue of sale of long term investments was not given in the audit report for the period ended June 30, 2005 as the adverse opinion, as given in the prior period, was continued. It was also stated that the price of Rs.333/share of USML was taken from the value



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

of shares offered to the quantum shareholders/sponsors of the company at the time of its taking over by another group and at that point of time it was altogether different circumstances and it cannot be expected in the ordinary sales of shares at any other point of time, particularly 8 to 10 months before such sale. It was clarified that the audit report of 2004 raised doubt about existence of long term investment, while in the year 2005 the matter of existence stood resolved by appearance of sales and receipt of funds there against from third party and such funds were duly applied by investing in a bank's term deposits. Hence your reference to two situations existed in 2004 and 2005 are not identical which consequently renders repetition of same observation of 2004 in the year 2005 unwarranted. Moreover the financial statements of 2005 duly reflected the change of investments in the notes to the accounts and it not in any way indicates existence of transaction carried out in an unlawful manner. The sale agreement and Directors Authorization to affect the sale and letter of Representation-2005 furnished confirmed such sale. However the auditor's report dated October 3, 2005 carried negative opinion on the whole financial statements and it specifically stated that these financial statements do not give a true and fair view of the state of the company's affairs as at June 30, 2005 and of the loss and changes in equity.

7. Apart from the above, the auditors raised following further arguments:
- a. Auditors have given a clear written expression of opinion on the financial statements taken as a whole according to ISA 700.
 - b. ISA 200 clearly spells out the objective and general principles governing on audit of financial statements which states that there are inherent limitations in an audit that effect the auditors ability to detect material misstatements. These



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

limitation results from factor such as use of testing, inherent limitation of any accounting and internal control system and the fact that most audit evidence is pervasive rather than conclusive.

- c. The auditors totally denied whatever is alleged in the show cause notice and that they had fully discharged their duty by qualifying the matter regarding the investment in the shares of USML in their report dated January 04, 2005 on the accounts for the year ended September 30, 2004 and It would be therefore highly unjustified to assume that any willful concealment to the shareholders to benefit the management had been made by the auditors in this case.
- d. Negative opinion on the financial statements of both the periods constituted fair and professional discharge of duties devolved on us under the law and professional standards.

8. The auditors were provided with a hearing opportunity on September 5, 2006. Their partners Mr. Sheikh M. Tanvir, Syed Aftab Hameed, Mr. Hanif Razzaq and Mr. Walid Khalid, advocate appeared before the undersigned. The arguments submitted by them were already received in the written submissions earlier. They pleaded that the auditors acted professionally. The audit reports for both the years had adverse opinions in view of the state of affairs of the Company. However, they argued that the sale of shares was authentic and also that none of the minority shareholders had raised any voice against it. It was however, informed to them that few shareholders had file complaints against the transaction but at that time the Commission had already initiated the legal proceeding against the directors of the Company.



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

9. The circumstances of the case reveal the following non-compliances of the ISAs:

a. Para 7 of ISA 500 (Audit Evidence)

The auditors have stated in their letter dated May 18, 2006 that they had obtained sufficient audit evidences in the form of Sale Agreement, Directors' Authorization to affect the sale, Letter of Representation (LOR) on the accounts for the period ended June 30, 2005 and after examining the same found no reason to further qualify their report on this matter any more. However, Para 7 of ISA 500 (Audit Evidence) as regards the Sufficient Appropriate Audit Evidence states that "Sufficiency is the measure of the quantity of audit evidence. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for, or detecting misstatement in, the classes of transactions, account balances, and disclosures and related assertions. The quantity of audit evidence is affected by the risk of misstatement (the greater the risk, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Accordingly, the sufficiency and appropriateness of audit evidence are interrelated. However, merely obtaining audit evidence may not compensate for its poor quality". It was observed that the sale of the long term investment was made in non-transparent manner. The auditors' argument is unjustifiable as the audit evidence obtained was never sufficient and following important questions needing appropriate disclosure in their audit report dated October 3, 2005 on the accounts of the Company were completely overlooked



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

by the auditors. The auditors have also not forwarded any reply as to why these have been overlooked:

- i. Whether the sale was carried out in a transparent manner.
- ii. Whether the investment was sold at an arms length price.
- iii. What necessary steps Company took to receive bids/quotations for the sale of investment.
- iv. Why the transaction was not reported to the stock exchange after the sale for the information of all shareholders as the shares comprised a bulk shareholding of 22%.
- v. How Clearshore Ltd (UK), the purchaser, came to know that the shares were available for sale and appeared to be the only buyer for the investment.
- vi. Whether due risk assessment was carried out to cater for existence of risk of material misstatement in view of the fact that the Company is facing going concern issue.

The long term investment in the shares were sold to M/s Clearshore Ltd of UK in a ordinary manner in which no measures were taken to obtain a competitive price for a bulk shareholding of 22.4% in USML and which was held for 22 years. M/s Clearshore Ltd appeared as lone purchaser of the shares. There was no effort made by the Company to give an advertisement or invitation for bids for the sale. It has also not been clarified that how M/s Clearshore Ltd came to know about the sale of the shares whereas shareholders were never informed about the sale. The sale was made in unlawful manner as shares were sold through an agreement and the



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

transaction was not reported to the Stock Exchange as per listing requirements. It needs to be emphasized that all of the above questions regarding the sale of the shares remained unanswered and stayed unnoticed by the auditors. Key audit evidence was not sought for by the auditors. Consequently the shareholder and other stakeholders were kept in the dark about the sale of long term investment as the fact was not highlighted in the auditor's report for the year ended June 30, 2005.

b. Para 38 of ISA 501 (Audit Evidence - Additional consideration for specific items)

The Long Term Investments in the shares of USML constituted 61% of the total assets of the Company and the Company was facing going concern issue. The investment was material in nature and additional consideration was needed to be given for this specific item as regards the audit evidence to be obtained in light of para Para 38 of ISA 501 which states that when long term investments are material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding their valuation and disclosure. In the present case the said investment was sold in a non-transparent manner. The auditors have stated that the they had obtained sufficient audit evidences in the form of Sale Agreement, Directors' Authorization to affect the sale, Letter of Representation (LOR) on the accounts for the period ended June 30, 2005 and after examining the same found no reason to further qualify their report on this matter any more. The auditors have also stated in letter dated May 18, 2006 in reply to the Enforcement Dept. letter No. EMD/233/75/2004-10283 that the matter of sale of investment as well as Board



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

Resolution dated September 2, 2004 was concealed from them in the year ended September 30, 2004. The auditors, while conducting the audit for the period ended June 30, 2005, failed to take in to account the fact as to why the matter was concealed from them in the last year. Instead, the auditors treated the transaction as bona fide sale and considered Board Resolution and the Sale Agreement as sufficient audit evidence. It appears that the auditors deliberately avoided disclosure of related information regarding the sale of shares in their audit report dated October 3, 2005 to the disadvantage of the shareholders and the Company.

c. Para 13 of ISA 710 (Comparatives)

The auditors report dated October 3, 2005 on the period ended June 30, 2005 does not give an emphasis of matter para on the material issue of sale of long term investment by the Company which was qualified in the preceding year audit report. The investment constituted 61% of the total assets as per audited accounts for the year ended September 30, 2004 and was 22.4% of the total shareholding of USML. Para 13 of ISA 710 states that when the auditor's report on the prior period, as previously issued, included a qualified opinion, disclaimer of opinion, or adverse opinion and the matter which gave rise to the modification is resolved and properly dealt with in the financial statements, the current report does not ordinarily refer to the previous modification. However, if the matter is material to the current period, the auditor may include an emphasis of matter paragraph dealing with the situation. The auditors' point of view in this case is that emphasis of matter para on the issue of sale of long term investments was not given in the audit report for the period



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

ended June 30, 2005 as the adverse opinion, as given in the prior period, was continued. The fact is however that although the adverse opinion was given in both the years but a material fact of sale of investment was not brought to knowledge of shareholders through an emphasis of matter para. Even if the view point of auditors is considered authentic, the emphasis of matter para must have been given keeping in view the facts that the Company was facing going concern issue, the investment sold was a material asset of the Company and the Board Resolution/sale agreement was intentionally concealed from all including the auditors and it was brought to the notice of the auditors in the next financial year.

Further, a fact needs to be taken in account that the shares were sold at a throwaway price of Rs.16 per share through an agreement signed on November 10, 2004 and the auditors signed the auditors report on October 3, 2005. the market value of the share by that date had sky rocketed to Rs.120 per share yet the auditors did not consider it worth to give a matter of emphasis para in their report due to which the interest of the shareholders was hurt and they were kept aloof of a material transaction which placed them in a disadvantageous position and went to the benefit of the directors as ultimately the directors sold these shares as Principal Shareholders at an exorbitant price of Rs.333 per share.

10. 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,



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

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.

11. The duties and responsibilities of an auditor appointed by the shareholders under Section 252 of the ordinance can best be understood if we look at the place of an auditor in the scheme of the company law. The capital required for the business of a company is contributed by its shareholders who may not necessarily be the persons managing the company. In the case of a listed company, the general public also contributes towards the equity of the company. Such persons do not have any direct control over the company except that they elect directors for a period of three years and entrust the affairs of the company to them in the hope that they will manage the company to their benefits. The shareholders are, therefore, the stakeholders and the ultimate beneficiaries. Practically, however, the shareholders have no control over the way their company is managed by the directors appointed by them. It was, therefore, necessary that there must be some arrangement in place whereby the shareholders who are the real beneficiaries must get some independent view as to how the directors have managed the affairs of the company. The law, therefore, recognizing this situation, has provided that the shareholders should appoint an auditor who shall be responsible to audit the accounts and books of account and make out a report to them at the end of each year. This is the only safeguard provided by law to the shareholders to ensure that the business is carried on by the directors in accordance with sound business principles and



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

prudent commercial practices and no money of the company is wasted or misappropriated. 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 accounts and books of accounts.

12. In our socio-economic environment chartered accountants, who act as auditors of listed and other companies enjoy a position of great respect. Accounts audited by them and reported upon carry a weight and are relied upon by various authorities and stakeholders. They are also often called upon to issue their certifications on various issues, by various authorities, stakeholders and also by international organizations, as a means to provide due comfort to these authorities, stakeholders and organizations for their intended purposes. Even otherwise, Chartered Accountants are viewed as very respected and noble professionals in our social fabric. For these reasons, it is further more important for the auditors to exercise due diligence in performing their duties and discharging their responsibilities. Their failure in exercising due professional care and diligence also amounts to a breach of trust which the society in general and statue in particular has reposed in them. Careless and casual attitude and not exercising due diligence by the auditors while discharging their responsibilities and issuing their reports may spell disaster for such trust and confidence.

13. Now, reverting to the present case, it is clear from the preceding paragraphs that the auditors failed to perform their professional duties with reasonable degree of care and skill. It



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

is therefore viewed that the auditors have committed a breach of fiduciary duty cast upon them by the shareholders.

14. After consideration of the facts and circumstances of this case, I am of the view that the auditors have signed the audit report otherwise than in conformity with the requirements of Section 255 of the Ordinance and have committed a willful default in terms of Section 260 of the Ordinance and have made themselves liable for punishment under Sub-section (1) of Section 260 of the Ordinance. Accordingly, I impose a fine of Rs.100,000 (Rupees one hundred thousand only) under Sub- section (1) of Section 260 of the Ordinance on Mr. Hyder Ali Bhimji, the engagement partner of the auditors.

15. Mr. Hyder Ali Bhimji, FCA is directed to deposit the fine of Rs.100,000 (Rupees one hundred 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 receipted bank voucher to the Securities and Exchange Commission of Pakistan.

(Ashfaq Ahmed Khan)
Director (Enforcement)

Announced
September 22, 2006
Islamabad.