Before

Amir M. Khan Afridi – Director/ Head of Department

In the matter of Show Cause Notice issued to

*****, Engagement Partner**
M/s EY Ford Rhodes & Company, Chartered Accountants
&
****, Engagement Partner**
M/s KPMG Taseer Hadi & Company, Chartered Accountants

Auditors of Pakistan International Airlines Corporation Limited

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Dates of Hearings	August 25, 2021 and September 13, 2021

Order-Redacted Version

Order dated April 15, 2022 was passed by Head of Department (Adjudication-I) in the matter of ***, Engagement Partner M/s EY Ford Rhodes & Company, Chartered Accountants & Mr. ***, Engagement Partner M/s KPMG Taseer Hadi & Company, Chartered Accountants Auditors of Pakistan International Airlines Corporation Limited. Relevant details are given as hereunder:

Nature	Details
1. Date of Action	Show cause notice dated July 19, 2021
2. Name of Company	Pakistan International Airlines Corporation Limited
3. Name of Individual*	***, Engagement Partner M/s EY Ford Rhodes & Company, Chartered Accountants & ***, Engagement Partner M/s KPMG Taseer Hadi & Company, Chartered Accountants Auditors of Pakistan International Airlines Corporation Limited
4. Nature of Offence	Proceedings were initiated in terms of the Sections 255 and 260(1) of the Companies Ordinance, 1984 read with Section 476 thereof. Brief facts of the case are that review of annual audited financial statements of the Company for the year ended December 31, 2017 (**the 2017 Accounts**) transpired that the Company had made accounting adjustments as 'correction of errors' with respect to (i) Rs. 915 million for **unidentified balances** in different heads; (ii) Rs. 3,985 million for advance against transportation/**unearned revenue**; and (iii) Rs. 4,700 million for revenue related **taxes** for which information was not

	available. The aforesaid balances emerged during the year 2017 due to transitioning from legacy accounting and revenue system to new Enterprise Resource Planning (Oracle Financials) and revenue accounting system by the Company. In addition to the aforesaid, the Company also restated its obligation for **compensated absences** of the amount of Rs. 1,699 million in the 2017 Accounts as 'correction of error'. Review of the auditors' report on the 2017 Accounts transpired that auditors' have issued a qualified opinion on the 2017 Accounts. It *prima facie*, appeared that Accounts of the Company for the year ended December 31, 2016 were misstated and Auditors of the Company, *prima facie*, failed to highlight the aforesaid misstatements in auditor's report for the respective year. Hence, the auditor's report on the said Accounts of 2016 was not in accordance with the requirements of Section 255 of the Ordinance and International Standards on Auditing (**ISAs**) as the auditors of the Company failed to bring out material facts about the affairs of the Company making them liable for action under Section 260(1) of the Ordinance. In view of the above, proceedings were initiated through SCN dated July 19, 2021 under Section 255 and 260(1) of the Ordinance read with Section 476 thereof and the Respondents were called upon to show cause in writing within fourteen days of SCN as to why penalty may not be imposed in terms of Section 260(1) of the Ordinance.
5. Action Taken	Key findings were reported in the following manner: Keeping in view the facts of the case, relevant provisions of the Ordinance and of the applicable ISAs, arguments put forth by the Respondents and replies submitted in writing, it is stated that: a) In terms of notes 5.1 and 5.2 to the 2017 Accounts, following "correction of errors" were, *inter alia*, reported by the Company: *(i)* *"**5.1-Migration to new ERP*** *As disclosed in note 5.3 to the half yearly financial statements for the period ended June 30, 2017, during the year the Company migrated from its legacy accounting system (COSSAP) to new ERP system (Oracle Financials) and also migrated from legacy revenue accounting system (AVRA) to new revenue accounting system (RAPID). During aforesaid migration and implementation of ERP and RAPID, management faced numerous challenges including migration of data and recognition of balances in new system, personnel training and dissemination of system understanding to the users of new system.* ***The aforementioned challenges manifested in significant system deficiencies, errors and unidentified balances, which could not be completely addressed before conclusion of the half yearly***

	financial statements for the period ended June 30, 2017. *In order to resolve the subject problems before finalizing annual financial statements for the year ended 2017, management carried out an exercise focusing on following key areas:* *Migration of closing balances appearing in the legacy system to ERP as opening balance with invoice level details.* *Reconciliation of the general ledger balances with their respective subsidiary ledgers.* *Compilation of complete record of sales from sales reports and computation of unearned revenue by extracting data of tickets utilized during the year from the revenue accounting system. This resulted in arriving at the balance of Advance against Transportation (Unearned Revenue) with ticket wise breakup as at December 31, 2017 which is also traceable to the actual utilization of those tickets in the subsequent period.* *Identification of amounts payable to various foreign Airport Authorities in respect of taxes collected at the time of sale of tickets, including balance of taxes payable against ticket not utilized till December 31, 2017.* *(ii)* *The amount of unidentified balances of* ***Rs. 915 million*** *in different account heads could not be traced against any vendor. In this respect, management believes that these unidentified balances are* ***<u>a result of incorrect adjustment and / or over accrual of liabilities</u>*** *in previous years.* *(iii)* *While computing detailed breakup of advance against transportation (unearned revenue), an amount of* ***Rs. 3,985 million****, which was being carried forward from previous years, could not be related to any ticket unutilized during the current financial year and future available record.* ***<u>No breakup or information is available to support this amount and the management believes that this amount is a result of error in recording unearned revenue in prior years including time barred tickets.</u>*** *(iv)* *Based on detailed scrutiny of amounts payable to various authorities in respect of taxes collected at foreign stations against sale of tickets, an amount of* ***Rs. 4,700 million*** *was identified being unallocated to any related agency/authority.* ***<u>Management believes that this amount has accumulated over the previous periods owing to incorrect accounting adjustments.</u>*** *(v)* *In order to* ***depict correct position****, the aforesaid amounts in respect of unidentified balances in different heads, advance against transportation (unearned revenue) and foreign taxes payable respectively which were being carried forward from previous years, have been reversed by adjusting opening balance of accumulated*

losses. As it was not possible to ascertain the impact for the year 2016 and for earlier years, these amounts have been adjusted/ restated as at January 01, 2017.

(vi) *While reviewing primary data for* ***actuarial valuation management identified certain errors in understanding of actuary in respect of un-availed leaves data used for actuarial valuation****. Consequently, the Company has* ***restated its liability*** *on account of* ***compensated absences*** *with a corresponding effect on shareholders' equity.* ***The error*** *has been corrected retrospectively in accordance with IAS 8 by restating the balance sheet for the year 31 December 2016 and 01 January 2016.*

The aforesaid, disclosures transpired that errors, as reported by the Company, of the amounts of Rs.9,600 million against mentioned head of accounts were in existence at the time of issuance of annual audited financial statements of the Company for the year ended December 31, 2016. The Auditors, however, did not highlight the aforesaid errors, that were in existence, while issuing auditors' report for the annual audited accounts for the year ended December 31, 2016.

b) With regard to the submission of the Respondents that due to system limitations such errors, were reported by the Company, could not be identified and subsequent to new ERP system implementation, identification of such incorrect advance against transportation became possible, and which also resulted change in accounting for the purpose of recording sales.

In this regard, I, am of the view that, it was the responsibility of the Respondents to take necessary steps and obtain reasonable assurance from the Company to ascertain that the financial statements for the year ended December 31, 2016 are free of all the errors including the aforesaid errors. In case such errors existed at the end of financial year ended December 31, 2016, it was the responsibility of the Respondent to modify the auditors' report accordingly. It is also highlighted that unearned revenues reflected a significant increase from Rs. 7,906 million as of 2013 to Rs. 11,293 million as of 2016; which shows that increase of Rs. 3,387 million i.e. 42%. In terms of ISA 705; significant and material information was available to the Respondents to highlight irregularities in auditors' report of 2016, however, they did not discharge their responsibilities in terms of Section 255 of the Ordinance and applicable framework.

c) As per the submission of the Respondents supporting documents related to unearned revenues and taxes payables were not available at the time of audit. In this context, I am of the

	view that in the absence of reliable information, in terms of para 5 of IAS-8; the aforesaid are reported as errors by the Company. Moreover, in terms of definitions and relevant paras 36-44 of IAS-8 (accounting policies, changes in accounting estimates and errors), prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more periods arising from a failure to use, or misuse of, reliable information that was available when financial statements for those periods were authorized for issue and could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. The relevant IAS describes that such errors may include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud. The Respondents are of the view that the circumstances which resulted in the revision of unearned revenue amounts in the year 2017 were in fact not 'prior period errors' for the simple reason that the information which was used to adjust the unearned revenue amount was not available when the 2016 financial statements were issued. The aforesaid stance of the Respondents is not acceptable as the directors' report annexed with half yearly accounts of the Company for the period ended June 30, 2017 and its note 5.3 highlighted, *inter alia*, following details: *"Directors' report- For the period under review external auditors have given a disclaimer regarding various issues arising as a result of migration to new ERP system. A well-integrated I.T system with efficient internal controls is a pre-requisite for making informed and timely decisions. Process for implementation of Oracle based ERP system in PIACL was initiated in year 2016, core modules were made fully functional in January 2017."* *"note 5.3: This represents capitalization of new ERP system. Effective from January 2017, the Company has migrated from old accounting system "COSSAP" to new ERP system which includes modules namely General Ledger, Supply Chain, Cash Management and Treasury, Accounts Payable, Accounts Receivable and Fixed Asset. These modules were made Go-live during the six months period ended June 30, 2017 except for Fixed Asset Module which was made Go-live subsequently. The Company has discontinued the maintenance of old COSSAP with effect from March 31, 2017. The process of migration of data has not yet been fully completed, however, modules of ERP system have been functional during the period with exceptions. During the implementation of ERP system, significant nature of system deficiencies, errors and unidentified balances were identified pertinent to the collection of accounting information for the six months period ended and migration of data."*

	The aforesaid information transpires that new ERP based system was initiated in year 2016 and core modules were made functional in January 2017. Moreover, the Company discontinued the maintenance of old COSSAP with effect from March 31, 2017 i.e. before the date of issuance of auditors' report for the year ended December 31, 2016. The Respondents, being auditors of the Company, however, despite the availability of information did not highlight the amounts of unidentified balances, unearned revenues and foreign taxes payables, despite the aforesaid amounts were material and beyond the materiality threshold of Rs. 1 billion, in their auditors' report for the year ended 2016. Nonetheless, if no such information was available, it was the responsibility of the Respondents to seek the reasonable assurance that the financial statements were free from material misstatements and all the disclosures were made in accordance with the financial reporting framework. The Company's Accounts for the year 2016 were approved by the board of directors in September 2017 and adopted by the members in annual general meeting of the Company held on November 25, 2017. The above clearly reflects that since the core modules were fully functional in January 2017, hence, the amounts or information of prior period errors of unidentified balances, unearned revenues and taxes, were available before finalization of 2016 Accounts. In this regard, I am of the view that stance taken by the Respondents is not tenable and they did not discharge their responsibilities in terms of Section 255 of the Ordinance. d) As regards to error of Rs. 1,699 million reported in cases of compensated absences, the Respondents are of the view that they placed reliance on the work of the actuary and due audit procedures were performed. The Respondents are also of the view that it was human error on the part of the auditors. I am of the view that the aforesaid error was material and was above the materiality threshold of the Auditors. The Respondents, however, did not provide any cogent reason that at the time of auditors' report for the year 2016 they took necessary steps and sought reasonable assurance to verify the amounts of compensated absences. Had the same been done, the error of Rs. 1,699 million against compensated absences might not be reported in 2016 Accounts. In this regard, I am of the view that the Respondents did not discharge their obligations in terms of Section 255 of the Ordinance and applicable frameworks.

	e) The Respondents stance that amount of unidentified balances of Rs. 915 million were below the materiality threshold, is not tenable, as the said amount was significant in nature, however, the Respondents did not highlight the said error that caused misreporting of Rs. 915 million in the 2016 Accounts. f) I am of the view that the Respondents did not carry out audit procedures in terms of the requirements of the applicable ISAs and the Ordinance to highlight the aforesaid material errors. The aforesaid amounts were material when compared with loss for the year of Rs. 45.382 million. Moreover, I am also of the view that reporting some irregularities in the management letter does not absolve the Respondents from their obligations as they were required to discharge their responsibilities in terms of Section 255 of the Ordinance as 2016 Accounts did not give true and fair view due to the aforesaid errors reported by the Company. g) The Respondents are of the view that they included a qualification in auditors' report of 2017 on the treatment of adjustment adopted by the management for the adjustments of unearned revenue and related taxes, as they did not believe that such adjustments represented any **error or misstatements** in relation to the information reported in the 2016 financial statements. In this regard, it is relevant to reproduce the qualification reported in auditors report for the year 2017, that, *inter alia*, stated that: *"While these exercises have reasonably established the unearned revenue and related taxes as of 31 December 2017, it could not be determined in appropriate manner whether sufficient and reliable information/data was available based on the accounting and reporting system of the Company as implemented in 2016 and earlier years. Accordingly, we were not able to satisfy ourselves whether these adjustments should have been classified as an* ***error or estimate*** *in terms of the requirement of International Accounting Standard (IAS 8) "Accounting Policies, Changes in Accounting Estimates and Errors".* In this regard, I am of the view that the aforesaid qualification did not specifically highlight that unidentified amounts were estimates. Hence, stance of the Respondents that they qualified subsequent auditors' report for the year 2017 on the matter of unidentified balances is not acceptable. h) It is relevant to highlight that auditors of the Company in their limited scope review report for the half year ended June 30, 2017, i.e. subsequent to financial years ended December 31, 2016, also highlighted reasons of system deficiencies, errors and unidentified balances encountered during the collection of accounting information for the period ended and migration of

data. The auditors, hence, gave a disclaimer of opinion. The basis of disclaimer of auditor's opinion is given as below:

> *"As disclosed in Note 5.3 to the unconsolidated condensed interim financial information, the Company has managed its accounting system to a new ERP system in January 2017; which includes the general ledger system and certain modules to record, process and report financial transactions and balances. The Company has discontinued the maintenance of the old accounting system with effect from March 31, 2017. The complete required information and reports with accuracy are not available due to the significant nature of system deficiencies, errors and unidentified balances encountered during the collection of accounting information for the period ended and migration of data. Consequently, accounting information available in ERP system has not been fully evidenced. As a result of these matters, we were unable to determine whether any adjustments might have been necessary in respect of recorded or unrecorded account balances, and accordingly, of the elements making up the unconsolidated statement of financial position and the related unconsolidated interim statements of profit and loss, comprehensive income, cash flows and changes in equity."*

In this regard, I am of the view that the auditor's opinion on financial statements for the period ended June 30, 2017, which is of immediate subsequent period; is significant evidence that the 2016 Accounts were based on incorrect accounting information due to errors or unidentified balances.

i) In terms of Section 255 of the Ordinance the powers and duties of the auditors have been provided, which, *inter alia*, provides that whether or not in their opinion and to the best of their information and according to the explanations given to them, the said accounts give the information required by this Ordinance in the manner so required and give a true and fair view. I, am of the view that the Respondents have not discharged their obligations in accordance with the provision of Section 255 of the Ordinance and relevant ISA(s). Reliance of previous practice of the Company, does not exonerate and absolve them for not highlighting the errors, amounting to Rs. 11,299 million and for not modifying the reports accordingly.

j) It is important to note that the financial statements are the key source of information about the operational efficiency and financial stability of a listed Company. A statutory auditor is obligated to follow the requirements of the Ordinance, and to carry out audit procedures in terms of ISAs and to express an opinion using professional judgement and maintaining professional skepticism. Further, an auditor is required to

	identify and assess risks of material misstatements, obtain sufficient appropriate audit evidence and form an opinion based on conclusion drawn from such evidence. However, in view of the observations above, it is clear that the Respondents did not discharge their obligations in accordance with the provision of Section 255 of the Ordinance and relevant ISA. From the above discussion and after careful consideration of all the facts of the case, I, am of the view that the Auditors of the Company did not appropriately highlight the material facts in the respective Auditor's Report on financial statements of the Company for the year 2016. Hence, the Auditor's Report on the aforesaid Accounts were not in accordance with the requirements envisaged in terms of Section 255 of the Ordinance and ISAs, hence, liable for action under Section 260(1) of the Ordinance. Keeping in view the above, in terms of Section 260(1) of the Ordinance, for the aforesaid violations, I, hereby impose an aggregate penalty of **Rs. 100,000/- (Rupees One Hundred Thousand only)** on the Respondents Nothing in this Order may be deemed to prejudice the operation of any provision of the Act providing for imposition of penalties in respect of any default, omission, violation of the Act.
6. Penalty Imposed	**Rs. 100,000/- (Rupees One Hundred Thousand only)**
7. Current Status of Order	Appeal was filed.