Corporate Supervision Department
Company Law Division

SECP **Before Abid Hussain – Executive Director (Corporate Supervision Department)**

In the matter of

Z.A. Nasir & Co., Chartered Accountants- Auditors of Laser Sports Private Limited

Number of SCN: CSD/ARN/249/2015-2397
Date of SCN: January 12, 2106

ORDER

UNDER SECTION 260 READ WITH SECTIONS 255 AND 476 OF THE COMPANIES ORDINANCE, 1984

This order shall dispose of the proceedings initiated against Z.A. Nasir & Co., Chartered Accountants (the "Auditor"), in respect of audit of annual financial statements (the "Accounts") of Laser Sports Private Limited (the "Company") for the years ended June 30, 2013 and 2014. The proceedings against the respondent were initiated through show cause notice ("SCN") dated January 12, 2016 under the provisions of section 260 read with sections 255 and 476 of the Companies Ordinance 1984 (the "Ordinance").

2. The brief facts of the case are that examination of Accounts for the year ended June 30, 2013 and 2014 of the Company, a medium sized entity ("MSE"), filed under section 242 of the Ordinance and the auditor's report annexed thereto, revealed that the Auditor gave an unmodified report. Review of the Accounts 2013 and 2014 further revealed the following:

i. As disclosed under note 3.12 to the Account 2014, the Company maintains an unfunded gratuity scheme, but it neither carried out the actuarial valuations of the accruing liability of the gratuity nor did it give any disclosures in this regard.

ii. The Company in respect of its unfunded gratuity scheme for its employees restated the comparative figures of 2013 in the Accounts 2014, as under (note 3.14):

"Restatements: Financial statements for the comparative period have been restated for the correction of an error of provision for gratuity as previously no provision was charged:

(Amounts in Rs)

Head of Account	Figures of 2013 Disclosed in Accounts 2013	Restated Comparative figures of 2013 disclosed in Accounts 2014
Liability – Provision for gratuity	Nil	1,035,000
Gratuity expense	Nil	575,465
Profit for the year 2013	10,828,859	10,253,394

Un-appropriated profits 2013	155,498,268	154,463,268

iii. the Company in the Accounts 2013 and 2014 did not provide any explanatory notes to the following line items in the balance sheet:

(Amounts in Rs)

Head of Account	2014	2013
Building Work in progress	75,987,520	63,811,558
Bills receivable (unsecured but considered good)	25,643,939	23,284,472
Issued share capital	20,000,000	20,000,000
Loan from Director (Interest free loan)	2,500,000	-
Provision for Gratuity	1,754,238	1,035,000
Loan from directors	49,013,500	-

3. The Auditor in his report to members, prima facie, did not modify his report in order to highlight:

a) the restatement of the respective comparative figures of 2013 in the Accounts 2014;
b) adequacy and appropriateness or otherwise of disclosures with respect to retrospective correction of the errors in corresponding comparative figures of 2013 in the Accounts 2014;
c) non-compliance with the applicable Accounting and Financial Reporting Standards ("AFRS") by not carrying out actuarial valuation of liability of gratuity in the Accounts 2013 and 2014; and
d) non-disclosure of necessary explanatory notes, which were necessary for the users' understanding, in respect of the material balance sheet line items in the Accounts 2013 and 2014.

Moreover, it was observed that the Auditors stamped and signed the Company's Accounts 2013 and 2014, which were also printed on the Auditors' letter head, in violation of the requirements of ICAP's Circular 4 of 1999 and the Framework for the Preparation and Presentation of Financial Statements, which states that the management of an entity has the primary responsibility for the preparation and presentation of the financial statements of the entity. The Auditor, prima facie, failed to highlight the aforesaid contraventions with the requirements of AFRS by the Company, hence, the audit report on the Accounts 2013 and 2014 was not in accordance with the requirements of section 255 of the Ordinance and ISAs and the auditor, prima facie, failed to bring out material facts about the affairs of the Company. Consequently, the SCN was issued to the audit engagement partner (the "respondent") of the Auditor.

4. In response to the SCN, the respondent submitted reply vide letter dated January 20, 2016 and made following submissions with regard to contents of the SCN:

a) The management has provided for a definite liability for Gratuity on the basis of

Clause-12 of Schedule to "Industrial and Commercial Employment Standing Orders (Ordinance, 1968)". It has been disclosed in the accounts that company maintains unfunded gratuity fund. Para 57 of IAS 19 only encourages but does not require an entity to involve a qualified actuary in the measurement of all post-employment benefit obligations. Therefore the audit report was not modified on account of actuarial valuation. However we will persuade the client for compliance in future.

b) In our opinion the entity has adequately disclosed the nature of error and the amount of the correction for each of the period presented in note 3.14 of the accounts. The auditor's report has not been modified on account of restatement of comparative figures of 2013 in the accounts of 2014 as reference para A6 of ISA 710 does not compulsorily require the auditor to include an emphasis of the matter paragraph highlighting the note regarding restatement.

c) The following line items in balance sheet adequately fulfill the requirements of Fifth Schedule of the Ordinance:

(i) Building Work in Progress: Fifth Schedule requires disclosing under property, plant and equipment, the item wise detail of significant capital work in progress (CWIP). As only one item is included under CWIP of the company and audit client has clearly disclosed the item (i.e. building), therefore, separate note was not given.

(ii) Bills receivable: Fifth schedule of the ordinance requires disclosing trade debts separately as considered good, considered doubtful and bad. The audit client has adequately disclosed it on the face of balance sheet that the debts were unsecured but considered good.

(iii) Issued Share Capital: As per requirements of para 1.21 of AFRS for SMEs the Company has disclosed on the face of balance sheet, the class of, the number of shares issued and par value of shares. However the entity has inadvertently omitted to disclose the consideration against which the shares have been issued.

(iv) Loan from directors: Sufficient and appropriate evidence has been obtained in respect of loan from directors before issuing the audit report. The loan has been appropriately classified as long and short term after taking into account the intensions and representations made by the management. The loan has been obtained to meet the working capital requirements of the company and is interest free. However, the disclosure of the fact has been inadvertently omitted from the accounts.

d) The auditors' letter head is not used but only a logo of the firm is placed on the company's Accounts only for identification purpose, otherwise we would have to sign and stamp each page of the accounts for the purpose of identification of the audited accounts as required by the banks. We believe that the management is solely responsible for the preparation and presentation of financial statements and adequate representations have already been taken before the issuance of audit report.

In view of above explanation the respondent submitted that a modified opinion was not necessary as there was no material misstatement. The respondent, however, gave assurance that efforts will be made to further improve the presentation in the light of observations as required by the Ordinance and IFRS, in future.

5. Before proceeding further, it is necessary to advert to the following relevant provisions of Ordinance, International Standards on Auditing ("ISAs") and applicable AFRS for MSEs:

AFRS for MSEs:

Para 1.1. requires that a complete set of financial statements includes components such as accounting policies and explanatory notes. (Emphasis Added)

Para 1.3. *An entity whose financial statements are drawn up in compliance with the standard and the Companies Ordinance, 1984 shall specify in its accounting policy note that these financial statements are in compliance with Accounting and Financial Reporting Framework for MSEs and the Companies Ordinance, 1984.*

Para 1.31. *The notes to the financial statements of an entity shall:*
(c) provide additional information that is not presented on the face of the financial statements but that is necessary for a fair presentation;

Para 12.13. *An entity shall correct material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by:*
(a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or

(b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

Para 12.15. *An entity shall disclose:*

(a) the nature of the error; and

(b) the amount of the correction for each prior period presented. (Emphasis Added)

Para 17.8. *In respect of gratuity benefit and other defined benefit schemes, the accounting treatment will depend on the type of arrangement which the employer has chosen to make.*

(a) *If the employer has chosen to make payment for retirement benefits out of his own funds, an appropriate charge to the statement of profit and loss for the year shall be made through a provision for the accruing liability. The accruing liability shall be calculated according to actuarial valuation. However, entities may opt to calculate the accrued liability by reference to any other rational method e.g. a method based on the assumption that such benefits are payable to all employees at the end of the accounting year.*

Para 17.9. *Where actuarial valuation is conducted, it shall be in accordance with requirements of IAS 19-Employee Benefits.*

ISAs:

Para A 1 and A 12 ISA 200:

A1. *The auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. The auditor's opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. In some jurisdictions, however, applicable law or regulation may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. While the ISAs include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions.*

A12. *The opinion expressed by the auditor is on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. The form of the auditor's opinion, however, will depend upon the applicable financial reporting framework and any applicable law or regulation. Most financial reporting frameworks include requirements relating to the presentation of the financial statements; for such frameworks, preparation of the financial statements in accordance with the applicable financial reporting framework includes presentation.*

Para 13 of ISA 700:

"In particular, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework:

(a) *The financial statements adequately disclose the significant accounting policies selected and applied;*
(b) *The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;*
(c) *The accounting estimates made by management are reasonable;*
(d) *The information presented in the financial statements is relevant, reliable, comparable, and understandable;*
(e) *The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and (Ref: Para. A4)*
(f) *The terminology used in the financial statements, including the title of each financial statement, is appropriate.* (Emphasis Added)

Para A2 and A4 of ISA 705:

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*

A4. *In relation to the appropriateness of the accounting policies management has selected, material misstatements of the financial statements may arise when:*

(a) *The selected accounting policies are not consistent with the applicable financial reporting framework; or*
(b) *The financial statements, including the related notes, do not represent the underlying transactions and events in a manner that achieves fair presentation*

Para 6 of *ISA 705*:

6. *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)*

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

ISA 706 contains provisions regarding drawing attention of users of financial statements to the matters disclosed in the financial statements or any other important undisclosed matters that are fundamental to users' understanding.

The provision of sub-section (3) of section 255 of the Ordinance prescribes requirements format and the manner of auditors' report on the Accounts , inter alia, provides that *the auditor shall make a report to the members of the company on the accounts and books of accounts of the company and on every balance-sheet and profit and loss account or income and expenditure and on every other document forming part of the bait nee-sheet and profit and loss account or income and expenditure account, including notes, statements or schedules appended thereto, which are laid before the company in general meeting during his tenure of office.*

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 willful, 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."*

6. I have analyzed the facts of the case, the relevant provisions of the Ordinance, requirements of AFRS and ISAs and the arguments put forth by the respondent. I have observed that as per requirements of the Ordinance, AFRS and ISAs quoted in the preceding paragraphs, the auditor was required to highlight non-compliances in the report on the Accounts 2013 and 2014 of the Company, in view of the following:

a) In terms of para 17.8. of AFRS for MSEs in case the employer has chosen to make payment for retirement benefits out of his own funds, a provision for the accruing liability shall be created and expense shall be charged to profit and loss. The accruing liability shall be calculated according to actuarial valuation. The entity, however, may choose another rational method to calculate the liability. The Company has made a provision for gratuity; however, it is unclear as to what method has been adopted by the Company in this regard. Moreover, the Accounts also do not give any disclosure regarding the method used or

Company's policy in this regard. Carrying out actuarial valuations by a professional actuary is not mandatory, but the method used by the Company and its policy in this regard has to be disclosed in the notes. This deficiency has not been highlighted in the Auditors' report.

b) The Company has not accounted for the liability in respect of gratuity in its Accounts 2013. However, this deficiency was not highlighted in the auditors' report on Accounts 2013. As a result the profit for the year was overstated by 5.6% which just meets the materiality threshold. Moreover, when the comparative figures of 2013 were restated in the Accounts 2014, the auditors' report neither highlighted the restatement nor did it contain anything on the auditors' agreement or disagreement on adequacy and appropriateness or otherwise of disclosures with respect to retrospective correction of the errors in corresponding comparative figures of 2013 in the Accounts 2014. The respondent has pleaded that adequate disclosures with respect to correction of respective figures were given by the Company; therefore, modification of opinion was not required. It has been emphasized by the respondent that in terms of para A6 of ISA 710, it is not compulsory to include an emphasis of the matter paragraph highlighting the note regarding restatement. It is important to note that given the fact that the liability previously not accounted for in the Accounts 2013 was accounted for in Accounts 2014 and comparative figures of 2013 were also restated. Since, the Auditors had audited both the Accounts; he should have highlighted the restatement through emphasis of matter or other matter paragraph in the report.

c) With respect to material line items in the balance sheet, it is viewed that the Accounts 2013 and 2014 do not give adequate disclosure. The Accounts do not disclose the Company's policy regarding work in progress. On the face of balance sheet, 'building work in progress' has been disclosed. However, notes to the Accounts neither give any further detail which may be necessary to understand the nature of the work in progress, not Company's accounting policy in this regard has been disclosed. The Company's disclosure regarding 'bills receivable' may be considered just sufficient, even though better disclosure could have been made by given a description of those for users' understanding. In respect of insufficient disclosure regarding paid up capital, it has been admitted by the

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respondent that the Company has inadvertently omitted to disclose the consideration against which the shares have been issued. Lack of disclosure regarding purpose and pricing of 'loan from director' has also been admitted by the respondent stating that the omission was inadvertent.

d) In respect of use of auditors' letterhead for preparation and printing of Accounts, it has been stated that the Accounts are not on letterhead of the Auditor, but only contain firm's logo to identify the Accounts and that otherwise the Auditor would have to sign and stamp each page of the accounts for the purpose of identification of the audited accounts as required by the banks. This plea is not tenable, because Auditor's logo, signatures and stamp are to be placed on the auditor's report only. Preparation of accounts is the responsibility of the BOD and hence these have to be signed by the chief executive and director of the Company. Moreover, the Auditor's stamp and signatures are also been embossed on the Accounts.

e) Even through it appears that due to the aforesaid non-compliances with AFRS by the Company, the Accounts 2013 and 2014 were not materially misstated, but they lacked some mandatory disclosures which were important for understanding of the users. Even though modification of auditors' opinion was not required under the circumstances, but the auditor was responsible to communicate the lack of disclosure in the Accounts to the management for rectification. In case of management's disagreement on giving appropriate disclosure, he should have been highlighted it through emphasis of matter of other matter paragraph in terms of requirements of ISAs and the Ordinance.

7. For the foregoing reasons, I am of the view that the provisions of section 260 of the Ordinance have been violated by the respondent as he has not highlighted the non-compliances of applicable AFRS by the Company in his report on Accounts 2013 and 2014. Moreover, despite the fact that due to the Company's failure to account for liability in respect of gratuity in Accounts 2013, the profit for the year was overstated by 5.6% which just meets the materiality threshold. The auditor should have modified his report on Accounts 2013. However, I take cognizance of the fact that the comparative figures of 2013 in Accounts 2014 were restated and corrected and due to lack

of other disclosures the Accounts 2014 were not materially misstated. Therefore, in view of the respondent's assurance to take up the matter with the Company for improved disclosure in the Accounts and to avoid such lapses in future, instead of imposing fine, I hereby conclude the proceedings with a warning to the respondent to be careful in future and ensure meticulous compliance with applicable provisions of the Ordinance and ISAs.

Abid Hussain
Executive Director (Corporate Supervisions Department)

Announced:
February 4, 2016
Islamabad