Before Ali Azeem Ikram, Executive Director/HOD (Adjudication-I)

In the matter of Show Cause Notice issued to Pakistan International Airlines Corporation Limited

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Dates of Hearing	January 6, 2021 and January 29, 2021

Order-Redacted Version

Order dated March 22, 2021 was passed by Executive Director/Head of Department (Adjudication-I) in the matter of Pakistan International Airlines Corporation Limited. Relevant details are given as hereunder:

Nature	Details
1. Date of Action	Show cause notice dated October 28, 2020
2. Name of Company	Pakistan International Airlines Corporation Limited
3. Name of Individual*	The proceedings were initiated against the directors and the Company i.e. Pakistan International Airlines Corporation Limited
4. Nature of Offence	In view of alleged violations of under Section 492 and Section 476 of the Companies Ordinance, 1984 through SCN dated October 28, 2020 and order dated March 22, 2021 was passed.
5. Action Taken	Key findings were reported in the following manner: I have analyzed the facts of the case, relevant provisions of the Ordinance, arguments put forth by the Authorized Representatives and replies submitted in writing. The case is summarized in the following manner: a. With regard to restatements as correction of errors were comprised of Rs. 11,299 million and were comprised of different heads (i) Rs. 915 million for unidentified balances (ii) Rs. 3,985 million for advance against transportation/unearned revenue (iii) Rs. 4,700 million for taxes payable. (i) It is relevant to refer to note 5.1 to the Accounts 2017, which disclosed the following: *"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 (***) to new*

	*ERP system (Oracle Financials) and also migrated from legacy revenue accounting system (***) to new revenue accounting system (***). During aforesaid migration and implementation of ERP and ***, 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.* *Above mentioned activity resulted in identification of following balances which were appearing in financial statements as at December 31, 2016 for which no information/ supporting record could be identified:* - *The amount of unidentified balances of Rs. 915 million in different heads could not be traced against any vendor, in this respect, management believes, that these unidentified balances are a result of incorrect adjustment and/ or over accrual of liabilities in previous years.* - *While computing detailed break-up 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 utilized during the current financial year and future available record. 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.* - *Based on detailed scrutiny of amount 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. Management believes that this amount has accumulated over the previous periods owing to incorrect accounting adjustments.* *In order to depict correct position, the amounts of Rs. 915 million, Rs. 3,985 million and Rs. 4,700 million 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 or*

	accumulated losses. As it was not possible to ascertain the impact for the year 2016 and for earlier years, therefore amounts have been adjusted / restated as at January 1, 2017. It is also relevant to refer to relevant paras of International Accounting Standard "IAS"-8 (accounting policies, changes in accounting estimates and errors) ("IAS-8") *A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.* *Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:* *(a) was available when financial statements for those periods were authorized for issue; and* *(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.* Further, paras 36, 42 and 44 of the IAS"-8 (Accounting Policies, Changes in Accounting Estimates and Errors) states that: *36. The effect of a change in an accounting estimate, other than a change to which paragraph 37 applies, shall be recognized prospectively by including it in profit or loss in:* *(a) the period of the change, if the change affects that period only; or* *(b) the period of the change and future periods, if the change affects both.* *42. Subject to paragraph 43, an entity shall correct material prior period errors retrospectively in the first set of financial statements authorized 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.* *44. When it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, the entity shall restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable (which may be the current period).* In terms of IAS-8, 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 Company is of the view that the aforesaid are accounting errors. In this context, I am of the view that the subject accounting errors cause financial statements false, incorrect or omitting material information, hence, fall within the ambit of section 492 of the Ordinance, and subsequent rectification or correction of such errors does not absolve the Respondents for the issuance of misstated or false or incorrect Accounts 2016, which thereby presented misleading information to the shareholders. Hence, provision of section 492 of the Ordinance and attracted and the Respondents are liable to be adjudicated under section 492 of the Ordinance.

(ii) It has been disclosed in Accounts 2017, that due to the migration to new accounting software; significant system deficiencies, errors and unidentified balances were highlighted. This include that amount of unidentified balances of Rs. 915 million, unearned revenue against transportation amounting to Rs. 3,985 million and foreign taxes payable of Rs. 4,700 million which were taken as correction of prior period errors and were reversed and the effects were taken retrospectively by adjusting opening balances as at January 1, 2017. It is also disclosed in the Accounts 2017 that relevant information or supporting record against such errors were not available and impact of such errors for the relevant to financial year could not be ascertained.

For unearned revenues, it was informed that due to technical restraints of legacy system *** it could not identify whether the tickets already purchased by the customers was in fact utilized by the said customer and this number ran in hundreds of thousands over the past several decades.

In view of the foregoing, for the aforesaid three head of accounts i.e. unidentified balances of Rs. 915 million, advance against transportation of Rs. 3,985 million and for foreign taxes payable of Rs. 4,700 million, the Company's financial statements for the year ended December 31, 2016 were materially misstated.

As per note 5.3 to the Accounts-2017, the Company has re-stated various classes of its liabilities and assets; cumulative effect of correction is as follows:

Rupees in millions

	Balance December 31, 2016			Balance January 01, 2016		
Particulars	Previously reported	Restated	Restatement	Previously reported	Restated	Restatement
Liabilities	144,595.8	133,113.6	11,482.2	120,695.6	1,218.7	119,476.915
Assets	37,081.3	36,880.1	(201.2)	34,860.6	-	34,860.6
Equity (Acc. losses)	316,738.2	305,457.2	11,281*	269,946.7		268,728.033
Out of Rs. 11,281 million, amount related to compensated absences of Rs. 1,698 million is accounted for as an error, balance approx. Rs. 9,600 million has been restated for January 01, 2017.						

The above disclosures reflect that correction of prior period errors amounting to Rs. 9,600 million for the aforesaid three heads of accounts were material and significant.

As per stance of the Company, error in recording of unearned revenue including time barred tickets resulted incorrect advance against transportation of Rs. 3,985 million which was outstanding as of December 31, 2016. As informed that due to system limitations such errors were not identified, however, incorrect advance against transportation, for which, as stated, neither substantive documents were available with the Company nor provided during the course of the said proceedings along with reason to record such incorrect advances. I, am of the view, it was the responsibility of the Company to collate sale of tickets and related unearned revenues so that financial statements of the Company do not present incorrect state of affairs of the Company. However, 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, 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. During the aforesaid years, unearned revenue increased by Rs. 3,387 million reflecting a 42% increase. Unearned revenues for the years 2008 to 2012 were range bound and were of Rs. 6,665 million as of June 30, 2012. In this regard, the aforesaid construed that the Accounts 2016 were materially misstated due to these errors.

(iii) The Company provided a copy of 'Application Service Provision Agreement for ***', dated October 9, 2016, however, annexure A for timetable plan was not found annexed with the said agreement. It is relevant to refer to directors' report as annexed with quarterly financial statements for the period ended June 30, 2017, in terms of which it was disclosed that: "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". Moreover, note 5.3 to the quarterly financial statements for the period ended June 30, 2017 also disclosed that effective from January 2017, the Company had migrated to new ERP system for modules including General Ledger, Supply Chain, Cash Management and Treasury, Accounts Payable, Accounts Receivable and Fixed Assets. It was disclosed that these modules were made Go-live during the six months period ended June 30, 2017 except for Fixed Assets Module which was made Go-live subsequently. The view narrated in reply dated January 28, 2021 that: "Due to technical constraints in the legacy system, this ticket-wise detailed information was not available with the management at the time of finalization of financial statements for the year ended December 31, 2016". The said stance that date of knowledge of the prior period errors became known to the Respondents in the year 2017 and not before, the same argument is not tenable. 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 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 foreign taxation, were available before finalization of Accounts 2016. The stance of the Respondents that the Auditors' Report for the year of 2016 provided that the Accounts 2016 were free from material misstatements; however, this view is not acceptable as subsequently errors were identified and corrected. 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."* I, am of the view that auditor's opinion in immediate subsequent period is significant evidence that Accounts 2016 were based on incorrect accounting information due to errors or unidentified balances and migration to new software system resulted identification of errors related to unidentified balances, advance against transportation and foreign taxes payable. The Company, hence, instead to identify such errors and unidentified balances at the relevant time of issue of Accounts 2016 waited for system implementation, despite the fact that the new ERP system i.e. *** was implemented in parallel with old system in January 2017 The Respondents were also aware of prior period errors before the issue of Accounts 2016 which were presented for approval in AGM of 2016 held on November 25, 2017 as old system had discontinued in March 2017. This clearly shows that the management was privy to the aforesaid misstatements before the approval of the Accounts 2016 and these Accounts were approved containing the material misstatement and error which were not rectified accordingly. Had these errors been rectified in the Accounts 2016, it would have an impact on the Company's Profit & Loss for the relevant period. The Company, however, waited for subsequent Accounts to rectify such errors as it was first year after conversion of the Company from a statutory corporation in 2016.

	The Company's Accounts for 2016 did not highlight the system limitations to its shareholders for identification of errors for the amounts related to unidentified balances, unearned revenues, foreign taxes payables. Moreover, the agreement for new ERP system was made in 2016 i.e. before the finalization of Accounts 2016, and at that time system limitations and scope of new ERP solution were clear. (iv) As informed by the Company that incorrect adjustments or over accrual of liabilities resulted unidentified balances of Rs. 915 million. In this regard, any reason or evidence was not furnished that why incorrect adjustments in relevant financial statements were made and an accumulated balance of Rs. 915 million was outstanding as of December 31, 2016. I, am of the view, that given the aforesaid admission, relevant Accounts for the year 2016 were incorrect to the extent of such incorrect adjustments which resulted unidentified balances of Rs. 915 million. (v) The view that prior period errors were evidenced only after successful implementation of the said modern system i.e. *** is in fact admission about incorrect Accounts 2016 as the balances in all relevant highlighted head of accounts were outstanding as of December 31, 2016. (vi) With regard to the matter that the books of Accounts 2016 were not closed till the date such errors were identified and the Respondents could have taken measure for rectification of error or remove the misstatement in the said Accounts; the Authorized Representative was advised to furnish last journal voucher w.r.t year 2016, in order to ascertain the date of close of Accounts 2016. However, such information was not shared. Moreover, information as to when the approval of board of directors/management was obtained for this *** along with related minutes was also not provided. From relevant available information, it is quite evident that new ERP system was implemented from first quarter of March 2017, and Accounts 2016 were approved by the members in November 2017, hence, the submissions in this regard are not acceptable. b. With regard to compensated absences of the amount of Rs. 1,699 million in the Accounts 2017 as 'correction of error'. (i) I would like to draw attention to note 5.2 to the Accounts 2017 disclosed following details about the obligations for compensated absences: *5.2- Obligation for compensated absences* *During the current year, the management as a part of reconciliation exercise, also reviewed the primary data used for actuarial valuation. As a result, of such exercise, 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 'Obligation for compensated absences' with a corresponding effect on shareholder's equity.* *The above error has been corrected retrospectively in these unconsolidated financial statements in accordance with the requirements of IAS 8- 'Accounting Policies Change in*

	Accounting Estimates and Errors' by restating the balance sheet for the year ended December 31, 2016 and January 1, 2016. Due to the restatement, the Company has presented the balance sheet as at the beginning of the earliest comparative period i.e. January 1, 2016, and related notes in accordance with the requirements of IAS 1- Presentation of Financial Statements'. (ii) The Company submitted that while reviewing primary data for actuarial valuation, management identified certain errors in understanding of actuary in respect of un-availed leave data used for actuarial valuation. The Company realized that understanding of actuary resulted in error which caused incorrect recording of compensated absences by Rs. 1,699 million. On identification, said errors were reversed in the year 2017 and an impact of Rs. 480.721 million was also charged to P&L of the year 2017. The aforesaid highlights that Accounts 2016 were incorrect to the extent of such compensated absences amount of Rs. 1,699 million. The reason for impracticability for correction of errors was not cited for head of accounts i.e. compensated absences. Hence, in terms of IAS-8 correction of such errors does not contain the shield of relevant standard and the same does not exonerate the Respondents from their responsibilities and liabilities. Moreover, I, am of the view, that the errors in case of recording of compensated absences amounting Rs. 1,699 million was not identified by the new system, rather as informed, management identified such errors. The aforesaid reflect the material and significant errors which resulted in incorrect Accounts 2016. In view of the aforesaid, I am of the view that the Accounts 2016 were misstated on account of compensated absence amounting to Rs 1,699 million. c. Consequent to said correction of errors, it resulted in adjustments of opening balances of Accounts 2017. Hence, it is construed that Accounts 2016 were materially misstated. The Accounts 2016 did not highlight these misstatements and any system limitations to identify such errors related to unidentified balances, advanced against transportation, foreign taxes payable and compensated absences. This depicts that due to these errors the Accounts 2016 were materially incorrect or false or omitted material information. Moreover Accounts 2016 does not have the disclosure as given in half yearly accounts for the period ended June 30, 2017 as all the events mentioned in half yearly accounts has already happened before signing of Accounts 2016. A penalty of Rs. 500,000/- (Rupees five hundred thousand) was imposed on the Respondent Company. Penalty order dated March 22, 2021 was passed by Executive Director (Adjudication-I).
6. Penalty Imposed	A Penalty of Rs. 500,000/- (Rupees five hundred thousand) was imposed on the Respondent Company.
7. Current Status of Order	Penalty was deposited. No Appeal has been filed by the respondents.