Corporate Supervision Department
Company Law Division

SECP **Before Ali Azeem Ikram – Executive Director (Corporate Supervision Department)**

In the matter of

Shafiq & Co., Chartered Accountants- Auditor of Haji Muhammad Siddique Welfare Foundation

Number and date of notice:	CSD/ARN/189/2015-810 dated October 1, 2015
Date of hearing:	January 4, 2016
Present:	Mr. Awais Butt, Representative

ORDER

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

This order shall dispose of the proceedings initiated against Shariq & Co., Chartered Accountants, (the "respondent"), auditor of Haji Muhammad Siddique Welfare Foundation (the "Company"). The proceedings against the respondent were initiated through show cause notice ("SCN") dated October 1, 2015 issued 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 annual audited financial statements ("Accounts") for the year ended June 30, 2014 of the Company filed under Section 242 of the Ordinance revealed the following discrepancies:

(i) No depreciation was charged on the fixed assets comprising cost of building of mosque situated in Chunian, District Kasur, in violation of the requirements of International Accounting Standard ("IAS") 16 – Property Plant and Equipment;

(ii) The statement of compliance was not prepared as required under Para 114 of IAS 1- Presentation of Financial Statements and Institute of Chartered Accountants of Pakistan ("ICAP") circular No. 7/2007 dated November 2, 2007;

(iii) Information regarding domicile and legal form of the entity and address of its registered office (or principle place of business, if different from the registered office) was not provided in the Accounts in terms of Para 138 of IAS 1- Presentation of Financial Statements;

(iv) Date of authorization for issuance of financial statement was not disclosed as per requirements of Para 17 of IAS 10-Events after the Reporting Date.

(v) In response to the Commission's letter dated February 19, 2015, the respondent vide letter dated May 2, 2015 submitted reply, analysis of which further revealed that the land on which mosque's building was constructed was donated by a philanthropist and its title was not transferred to the Company. The fact regarding non transfer of title of land to the Company, despite being a material fact, was not disclosed in the Accounts.

The respondent being the auditor of the Company for the year ended June 30, 2014, gave an unmodified opinion on the Accounts of the Company, despite the material discrepancies as highlighted at serial number (i) to (v) above. Hence, the audit report was not in accordance with the requirements of sections 255 and 260 of the Ordinance and it failed to bring out material facts about the affairs of the Company. Consequently, the SCN was issued to the respondent requiring him to explain within fourteen days, as to why penalty may not be imposed on him for the alleged contraventions.

3. Since no reply to the SCN was received, a hearing in the matter was fixed on December 22, 2015. In response to the hearing notice, the respondent through letter dated December 21, 2015 requested for adjournment, owing to his engagement regarding filing of tax returns. The hearing was rescheduled for January 4, 2016 and Mr. Awais Butt appeared before the undersigned on behalf of the respondent and mainly reiterated the earlier stance that was submitted through the respondent's letter dated May 2, 2015 in response to the Commission's letter dated April 29, 2014. A brief of submissions made in writing and during the hearing with reference to the contents of the SCN are given below:

(i) The Company is a small company with no public interest involved. The legal form of the Company is a welfare foundation registered under section 42 of the Ordinance and it is stated in note A to the Accounts.

(ii) The statement of compliance has been provided in note B of the Account that the entity is following approved accounting standards issued by ICAP for small sized entities.

(iii) Title of the land on which the mosque has been constructed was donated by a philanthropist and the title of the land has not been transferred in Company's name. The Company constructed the building and therefore, only cost of building has been included as assets of the Company. Note 2 to the Accounts states management's policy that it does not intend to depreciate the building on account of being a welfare organization rather a commercial entity. The statement due to clerical issues was printed partially for which apology is rendered and page with corrected statement is provided.

(iv) Haji Muhammad Siddique, after whom the foundation has been named, has demised. The mosque has been transferred in Company's books to save it from encroachment.

(v) The date of authorization is not a requirement of approved accounting standards for small sized entities; therefore, the same was not disclosed. However, it will be disclosed in future.

In view of the aforesaid, the respondent requested for condoning the omissions and withdrawal of the proceedings.

4. Before proceeding further, it is necessary to advert to the following relevant provisions of Ordinance, International Standards on Auditing ("ISAs") and applicable International Financial Reporting Standards ("IFRS") including International Accounting Standards ("IAS"):

IAS 1-Presentation of Financial Statements provides as under:

6. *Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.*

7. *The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:*
- *(a) it is probable that future economic benefits associated with the item will flow to the entity; and*
- *(b) the cost of the item can be measured reliably.*

16. *An entity whose financial statements comply with IFRSs shall make an explicit and unreserved statement of such compliance in the notes. An entity shall not describe financial statements as complying with IFRSs unless they comply with all the requirements of IFRSs.*

30. *After recognition as an asset, an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses.*

43. *Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.*

138. *An entity shall disclose the following, if not disclosed elsewhere in information published with the financial statements:*

- *(a) the domicile and legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different from the registered office);*

(b) a description of the nature of the entity's operations and its principal activities; and
(c) the name of the parent and the ultimate parent of the group.

IAS 10- Events after the Reporting Period provides as under:

17. *An entity shall disclose the date when the financial statements were authorized for issue and who gave that authorisation. If the entity's owners or others have the power to amend the financial statements after issue, the entity shall disclose that fact.*

The Commission's notification number SRO 23(I)/2012 dated January 16, 2012, inter alia, provides as under:

Para 2 B: Sized Company as under:

A Small-Si-Zed company shall be a company that:

(i) has paid up capital plus undistributed reserves (total equity after taking into account any dividend proposed for the year) not exceeding Rs25 million;

(ii) has employees not exceeding two hundred and filly at any time during the year; and

(iii) has annual turnover not exceeding Rs.200 million, excluding other income

Para 3: *Non-listed companies that are not Medium-Sized companies or Small-Sized companies shall follow the International financial Reporting, Standards notified by the Commission for the listed companies or any such standards as notified by this Commission from time to time.*

Clause 1A of Fifth Schedule to the Ordinance, inter alia, states as under:

Non-listed companies that are not Medium Sized Companies or Small Sized Companies shall follow the International Financial Reporting Standards notified by the Commission for listed companies under sub-section (3) of section 234 of the Ordinance or any such standards as may be notified by the Commission from time to time.

ISA 200 *"Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with International Standards on Auditing ("ISA 200")* provides as under:

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..........continued*

***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............continued*

ISA 705 *"Modifications to the Opinion in the Independent Auditor's Report"* (*"ISA 705"*) provides as under:

***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

***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)

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

Section 255 of the Ordinance prescribes powers and duties of the auditors and sub-section (3), 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."

5. I have analyzed the facts of the case, the relevant provisions of the Ordinance, requirements of IFRS, IAS and ISAs and the arguments put forth by the respondent. I have observed that as per requirements of the Ordinance, IFRS, IAS and ISAs quoted in the preceding paragraphs, the auditor was required to modify his report and opinion on the Accounts of the Company for the years ended June 30, 2014, in view of the following:

- In terms of the Commission's notification number SRO 23(I)/2012 dated January 16, 2012, as applicable at the relevant time, the Company is neither a small sized company nor a medium sized company because it does not have any paid up capital. Therefore, in terms of para 3 of the SRO, it was required to prepare its Accounts in terms of the IFRS. However, the Accounts of the Company were prepared as per Accounting and Financial Reporting Standards ("AFRS") for Small Sized Entities ("SSEs"). The respondent being auditor of the Company failed to highlight this fact in his report.
- The cost of construction of mosque has been booked as asset in the Accounts of the Company; however, the Company has not been charging any depreciation on the building. This is against the requirements of Framework for the Preparation and Presentation of Financial Statements (the "Framework") and IAS 16. In terms of the requirement of the Framework and IAS 16 an asset constituting property plant and equipment can only be recognized when it is probable that future economic benefits associated with the assets will flow to the entity and its cost can be measured reliably. Once the asset is recognized, it has to be depreciated over its useful life unless it is the land owned by the entity. Therefore, after the Company had booked the cost of the building of mosque as an asset, it was mandatory to charge depreciation. Since the Company has not complied with the requirements, the Accounts were not in conformity with the

requirements of the Framework and IFRS. The auditor failed to highlight the non-compliance in his report.

- It is clear that the title of the land on which the building of the mosque has been constructed, was not in the name of the Company. Despite being material, this fact has not been disclosed in the Accounts of the Company. The auditor again failed to bring out this material fact in his report to members.
- The statement of compliance given in the notes to the Accounts filed with the registrar did not contain any statement of compliance as required under Para 114 of IAS 1 and ICAP's Circular No. 7/2007 dated November 2, 2007. When upon the Commission's queries the respective notes and statement of compliance was submitted by the Company, it stated that the Accounts have been prepared in compliance with requirements of AFRS for SSEs. The Company clearly violated the requirement of IAS-1, the Commission's SRO 23(I)/2012 dated January 16, 2012 and Fifth Schedule to the Ordinance. The respondent's plea that the Company is a SSE is not tenable in view of the requirements of IFRS, Fifth Schedule and the Commission's SRO.
- The Company did not disclose the information regarding domicile and legal form of the entity and address of its registered office (or principle place of business, if different from the registered office) in terms of Para 138 of IAS 1, in the Accounts filed with the registrar. The respondent did not highlight this non-compliance in his report to members.
- Date of authorization for issuance of Accounts is a requirement of Para 17 of IAS 10. The Company did not disclose it in the Account and the respondent failed to highlight the non- compliance in his report.
- The aforementioned non disclosures of material facts and non-compliances with the requirement of the IFRS, Fifth Schedule and the Commission's SRO had material impact on the Account of the Company, however, the respondent failed to discharge his duties to bring out the material facts and highlight the non-compliances in his report to members.
- In terms of ISA 200, 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, which means it is the auditors' responsibility to express an opinion on this aspect and in case of non-compliance with applicable reporting framework, the auditor must modify his report. In terms of ISA 705, it is auditors'

responsibility to modify his report when he concludes that financial statements are no free from material misstatements. Material misstatements of the financial statements may arise when the selected accounting policies are not consistent with the applicable financial reporting framework, or the financial statements, including the related notes, do not represent the underlying transactions and events in a manner that achieves fair presentation.

- Section 255 of the Ordinance prescribes powers and duties of the auditors and also sets the format of auditors' report. In terms of section 260 of the Ordinance, it is duty of the auditor to bring out all material facts about affairs of the Company in his report to members. In the instant case, the respondent in his capacity as auditor has failed to discharge his duties as per requirements of the Companies Ordinance and the ISAs, as stated above.

6. I deem it necessary to make some observations on the role of auditor of a company. The duties and responsibilities of an auditor appointed by the shareholders under the law 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. They elect directors and entrust the affairs of the company to them in the hope that they will manage the company to shareholders' benefits. There is no such arrangement in place whereby the shareholders can have an independent view as to how the directors have managed the affairs of the company. The financial statements are the most important source of reliable information for the shareholders who make their investment decision based on such information. The financial statements not only show the financial position and performance of the company but also show the results of management's stewardship of resources entrusted to it. Therefore, correct reporting in the financial statements in line with applicable financial reporting framework is of utmost importance. The law, therefore, recognizing this situation, has provided for the appointment of auditors who shall be responsible to audit the books of account, documents and financial statements required by the law and make out a report on them at the end of each year. This being the only safeguard provided by law to the shareholders to ensure accountability of the management, put the auditors to a high level of accountability in case they fail to make out a report in accordance with the legal requirements. For

these reasons, it is of utmost importance for the auditors to exercise due care and diligence in performing their duties and discharging their responsibilities and maintain a high level of trust and integrity at their end.

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. However, in view of submissions of the respondent regarding the status of the Company being a welfare foundation that is being run by a family for welfare purpose, instead of imposing maximum penalty, I hereby impose a fine of Rs10,000/- (Rupees ten thousands only) on the respondent.

The aforesaid fine must be deposited in the designated bank account maintained with MCB Bank Limited in the name of the "Securities and Exchange Commission of Pakistan" within thirty days from the receipt of this order and receipted bank vouchers must be furnished to the Commission. In case of non-deposit of the fine, proceedings for recovery of the fines as arrears of land revenue will be initiated.

Ali Azeem Ikram
Executive Director (Corporate Supervision Department)

Announced:
January 5, 2016
Islamabad