



Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH NO. III

In the matter of

Appeal No. 25 of 2013

Mr. Asim Iftikhar ...Appellant
(Partner, Anjum Asim Shahid Rehman
Chartered Accountants)

Versus

Mr. Ali Azeem Ikram HOD, SECP ...Respondent

Date of hearing 05/09/13

ORDER

Present:

For the Appellants:

Mr. Mansoor Usman Awan (Advocate)

For the Respondent:

Ms. Amina Aziz, Director (Enforcement)

Mr. Tariq Ahmad, Joint Director (Enforcement)



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1. This order is in appeal No. 25 of 2013 filed under section 33 of the Securities and Exchange Commission of Pakistan Act (the “Commission”), 1997 against the order dated 12/04/13 (the “Impugned Order”) passed by the Respondent.
2. The facts leading to this case are that Anjum Asim Shahid Rahman, Chartered Accountants (the “Firm”) conducted the statutory audit of the books and books of accounts of Zephyr Textile Mills Limited (the “Company”) and made audit report on the financial statement of the Company for the year ended 30/06/09, 30/06/10 and 30/06/11. The aforesaid audit reports were signed by Mr. Asim Iftikhar, Partner, Anjum Asim Shahid Rahman, Chartered Accountants (the “Appellant”). The Board of Directors (“BOD”) of the Company proposed a cash dividend of Rs. 1.00 per share, i.e. 10% for the year ended 30/06/11. The said proposed dividend payment was presented for approval of the shareholder dated 09/10/11 in Annual General Meeting held on 31/10/11 (“AGM”). However, the Company was restricted from declaration/payment of dividend to shareholders by virtue of clauses of rescheduling/restructuring letter dated 30/09/09 (the “Letter”) and rescheduling/restructuring agreement dated 26/02/10 (the “Agreement”) entered by the Company with Bank of Punjab (the “Bank”). Clause 8 under head ‘other terms and conditions’ of the Letter and Clause J under section 14.3 of negative covenants of the Agreement expressly barred the Company from payment and declaration of dividend, respectively, without permission of the Bank. Examination of audited annual accounts of the Company from 30/06/09 to 30/06/11 (the “Accounts”) filed with the Commission transpired that the material facts regarding restriction on declaration/payment of dividend was not disclosed by Company in the respective notes to the accounts. The Appellant, being auditor of the Company in the aforesaid years, failed to give opinion on the non-disclosure of restriction



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to declare/payout dividend in the annual accounts for the year 2009, 2010 and 2011. The following issues were identified by the Respondent:

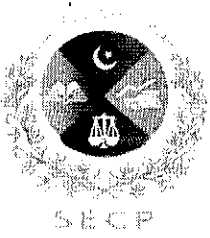
- i) the Company in its annual accounts for the year 2009 reflected that the principal approval by the Bank for the restructuring plan was acknowledged. The Appellant being auditor of the Company, in their report to the shareholders, did not give opinion with respect to non-disclosure of restriction on Company to payout dividend in lieu of the aforesaid restructuring plan;
- ii) the Company in its annual audited accounts for the year 2010 duly acknowledged that the loans of the Company had been rescheduled through the Agreement and effects of rescheduled loans have been duly incorporated in the said accounts. The restriction on Company to declare dividend (owing to said Agreement), despite being material information affecting the rights of the shareholders, was not reported, In spite of that, the Appellant issued an unqualified audit report regarding the affairs of the Company;
- iii) furthermore, the report of Appellant to shareholders dated 30/09/11 on the annual audited accounts for the year ended 30/06/11 disclosed the status of suit C.O.S No. 8/2011 filed by the Bank for recovery of amount due against long term loans and the restructuring agreement as part of the subject suit. Once again material information regarding restriction on declaration of dividend was not disclosed in the said report;
- iv) in addition to the aforesaid, in note 6.1 to the audited accounts for the years 2009, 2010 and 2011, under the head 'issued, subscribed and paid-up capital'



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it is categorically stated that all shareholders of the Company are entitled to receive all distribution to them including dividend and others in form of right and bonus as and when declared and all shares carry one vote per share without restriction. The Appellant, however, being auditor of the Company for the aforesaid years, failed to report to shareholders that shareholder's right to receive dividend is restricted owing to presence of restructuring letter/agreement; and

- v) it was noted that BOD in their meeting held on 30/09/11 had proposed cash dividend of 10% for the year ended 30/06/11. The shareholders being unaware of any restrictive rights to receive dividend owing to the facts narrated above, approved dividend as proposed by BOD of the Company in the AGM held on 31/10/11. The Appellant, being auditor of the Company was present at the aforesaid AGM of the Company, however, the Appellants did not raise the issue in the AGM.
3. Show cause notice dated 12/04/10 ("SCN") under section 260 read with section 255 of the Companies Ordinance, 1984 (the "Ordinance") was issued to the Appellant, calling upon them to show cause within 14 days of the date of the notice as to why penal action may not be taken against them. The date of hearing was fixed on 04/04/13. Mr. Nadeem Tirmizi, FCA, authorized representative of the Appellant, submitted a reply to the said SCN and also appeared on behalf of the Appellant on the date of the hearing. The Respondent, dissatisfied with the response of the Appellant, held that the Appellant had failed in its responsibility as an auditor to bring out material facts about the affairs of the Company and a penalty of Rs. 50,000/- was imposed on the Appellant.



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4. The Appellant has preferred to file the instant appeal against the Impugned Order. The Appellant's counsel argued that:

- (a) the Bank filed suit C.O.S No. 8/2011 in the Court for recovery of Rs. 494,400 million on 30/09/10 and an application was also filed by the Bank for stay of payment of dividend to its shareholders. In view of the pendency of the suit/application, any further proceedings by the Respondent or the Appellate authority would amount to pre-empting the adjudication of the aforementioned suit. It is established law that if a matter is pending adjudication before a higher forum, then the forum below should await the decision of the higher forum. The Respondent has passed the Impugned Order without taking into account the judicial propriety. Any liability of the Appellant with respect to the alleged non-disclosure of the restriction under the Agreement can only be ascertained after the order/judgment of the Court on the Agreement. Further, PLA No. 87-B/2011 of the Company before the Court in suit C.O.S No. 8/2011 has been accepted and the Company has been granted unconditional leave to defend vide order dated 13/03/12. The Impugned Order, therefore, is liable to be set aside as the matter is sub judice before a higher forum; and
- (b) it is evident from the minutes of the BOD meeting held on 30/09/11 that *'directors of the company unanimously decided to forfeit their right to receive dividend in the best interest of the company. The directors recommend cash dividend to all categories of shareholders except directors' shareholding.'* The direct beneficiaries of the resolution were the minority shareholders of the

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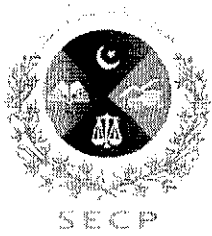


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Company including the Bank. The suit C.O.S No. 8/2011 had already been filed prior to BOD meeting on 30/09/11 and the Company at this point was not under any obligation to seek permission of the Bank before declaring the dividends. The Company, therefore keeping in view its profitability in the preceding fiscal year, approved payment of dividends in the AGM. Furthermore, the restriction on payment of dividend was imposed through the Letter after closing of the financial year 2009, as such; no disclosure was required in the accounts for the year 2009. In the year 2010, the Company was in loss and, as such, no disclosure on restriction of payment of dividend was required in the accounts for the year 2010. Moreover, the Company had also disclosed to its shareholders, the existence and pendency of the suit C.O.S No. 8/2011 filed by the Bank in the accounts for the year 2011 which itself was a sufficient disclosure. The disclosure requirement, if any, with respect to Clause J of section 14.3 of the agreement, would hold if the Agreement was in force. By virtue of its termination resulting in the recovery proceedings initiated by the Bank, any disclosure with respect to any specific provision of the agreement, became immaterial.

5. The department's representatives argued that:

- (a) the proceedings under section 255 of the Ordinance against the Appellant was initiated for, prima facie, failing to give opinion on the non-disclosure of restriction to declare/payout dividend in the annual accounts and an alleged misstatement in the accounts for the year 2009, 2010 and 2011. On the other hand, the Bank has initiated



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a suit for recovery of Rs 494,400 million against the Company. The nature of both the proceedings i.e. by Commission and in Court is different; and

- (b) the fact that directors waived off their right to receive dividend does not relieve the Appellant of his statutory responsibilities as an auditor of the Company. The Company in the accounts for the year 2009 and 2010 incorporated the financial effect of the Letter and Agreement. The argument of the Appellant that the said Letter/Agreement was not in effect, therefore, does not hold any merit as the Agreement is a matter of dispute but has not been set aside or deemed invalid by the Court. The restrictive clause i.e. Clause J of section 14.3 of the agreement, therefore, should have been disclosed in the notes to the accounts for the period 2009-11. Furthermore, the Company deliberately chose to avoid disclosure of restrictive clause regarding dividend in the notes to the accounts. Instead, the Company stated in its notes to the accounts that shareholders are entitled to all distribution including dividend as and when declared and all shares carry one vote per share without restriction. This note, in itself, is enough to establish misstatement by the Company. Moreover, the shareholders were kept in dark about the consequences of declaring dividend in presence of restrictive clause in the Agreement.
6. We have heard the parties. Sections 255(3) and 260(1) of the Ordinance, 1984 are reproduced here for ease of reference:



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255. Powers and duties of auditors.

- (3) *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 account and on every other document forming part of the balance-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, and the report shall state—*
- (a) *whether or not they have obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purposes of the audit;*
- (b) *whether or not in their opinion proper books of accounts as required by this Ordinance have been kept by the company;*
- (c) *whether or not in their opinion the balance-sheet and profit and loss account or in the income and expenditure account have been drawn up in conformity with this Ordinance and are in agreement with the books of accounts;*
- (d) *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) *in the case of the balance-sheet, of the state of the company's affairs as at the end of its financial year;*
- (ii) *in the case of the profit and loss account or the income and expenditure account, of the profit or loss or surplus or deficit, as the case may be, for its financial year; and*
- (iii) *in the case of the statement of changes in financial position or sources and application of funds of a listed company, of the changes in the financial position or the sources and application of funds for its financial year;*
- (e) *whether or not in their opinion-*



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- (i) *the expenditure incurred during the year was for the purpose of the company's business; and*
 - (ii) *the business conducted, investments made and expenditure incurred during the year were in accordance with the objects of the company ; and*
- (f) *whether or not in their opinion zakat deductible at source under the Zakat and Ordinance, 1980 (XVIII of 1980), was deducted by the company and deposited in the Central Zakat Fund established under section 7 of that Ordinance.*

260. Penalty for non-compliance with provisions by auditors.- (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 wilful, be punishable with fine which may extend to [one hundred] thousand rupees.*

- (a) section 255(3) of the Ordinance requires auditor to express an opinion to the best of their information according to the explanations given to them which gives a true and fair view relating to the affairs of the Company. The suit C.O.S No. 8/2011 filed in the Court by the Bank under section 9 of the financial Institution (Recovery of Finances) Ordinance, 2001 for recovery of Rs. 494.400 million on 30/09/10 pertains to breach of Agreement between the Bank and the Company, whereas, the proceedings by the Respondent is the basis of an alleged omission and misstatement in the notes to the said accounts of the Company and the Appellant's failure to fulfill his responsibilities as an auditor of the Company in terms of section 255 of the Ordinance. The subject matter of the Impugned Order is not the



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contractual dispute between the parties in respect of the Agreement, rather the Impugned Order deals with the negligence of the Appellant in failing to bring out material facts regarding non-disclosure of restrictive clauses of the Letter/Agreement in the annual accounts for the year 2009-11 and an alleged misstatement in the notes to the said accounts. In view of the facts discussed, the argument of the Appellants that the suit C.O.S No. 8/2011 filed by the Bank is pending before the Court, therefore, proceedings against them should be stayed until the outcome of the case, holds no merit; and

- (b) the Company chose to disclose in its annual accounts for the year ended 30/06/09 that the management of the Company has applied for restructuring of long term financing from the Bank. In light of the foregoing, the Company opted not to show maturity of the loans amounting to Rs. 34.00 million, Rs. 41.172 million and Rs.50 million under the head of current maturity of long term liabilities. The Company, however, did not disclose the fact that owing to the Letter, the Company had accepted the restriction on payment of dividends subject to No Objection Certificate from the Bank. The rescheduling effects of these loans were also incorporated in the accounts for the year ended 30/06/10. We are privy to the fact that the Company was in loss in the year 2010, hence, no dividend was declared. As such, the Company was not required to disclose the restriction on payment of dividend in the accounts for the year ended 30/06/10. The Company in its annual accounts for the year ended 30/06/11 disclosed that the Bank had filed a suit C.O.S 8/2011 for recovery of amount due against long term loans. The restriction of dividend, however, was not disclosed. Further, in notes to the accounts for the years 2009, 2010 and 2011, under the head '*issued, subscribed and paid-up capital*', it was categorically stated that shareholders of the Company are entitled to receive all distribution to them



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including dividend and other in form of right and bonus as and when declared and all shares carry one vote per share without restriction which was a misstatement on part of the Company under section 492 of the Ordinance. An order in terms of section 492 of the Ordinance by the Respondent for the alleged omission and misstatement in the accounts for the year 2009-11 has already been passed against the Company. It is pertinent to mention that for the year ended 30/06/12, the above mentioned statement that the Company is entitled to receive all distribution including dividend was not mentioned in the notes to the accounts, as such, the Company by their conduct have acknowledged the misstatement made in the accounts for the year 2009-11.

The Appellant as auditor of the Company cannot assume that the majority shareholders were aware of restriction on dividends. The Appellant by failing to give opinion on the Company's non-disclosure on restriction to declare dividend, did not perform his duties with due diligence in terms of section 255 of the Ordinance.

Clause 10(iii) of the Fourth Schedule to the Ordinance is reproduced for ease of reference:

10. There shall be added a footnote to the balance-sheet, showing separately,-

i) ...

ii) ...

iii) any other commitment, if the amount is material, indicating the general nature of commitment.



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We agree with the Respondent that the Company failed to disclose the nature of commitment owing to the Agreement and the Appellant as auditor failed to report the omission. International Financial Reporting Framework makes it clear that the report should contain enough data to allow individuals to estimate its value. Further, the Appellant was found negligent by failing to report the restriction to declare dividend to the shareholders and prospective investors.

In view of the above, we see no reason to interfere with the Impugned Order. The appeal is dismissed with no order as to cost.

(Mohammad Asif Arif)
Commissioner (Insurance)

(Imtiaz Haider)
Commissioner (SCD)

Announced on: 31/10/13